OVERVIEW: REVENUE OPTIONS AND REFORMING THE TAX CODE

HEARING

BEFORE THE

JOINT SELECT COMMITTEE ON DEFICIT REDUCTION CONGRESS OF THE UNITED STATES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

SEPTEMBER 22, 2011

Printed for the use of the Joint Select Committee on Deficit Reduction

U.S. GOVERNMENT PRINTING OFFICE

70–859—PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

JEB HENSARLING, Texas (R) *Co-Chair*
PATTY MURRAY, Washington (D) *Co-Chair*

XAVIER BECERRA, California (D)
FRED UPTON, Michigan (R)
JAMES CLYBURN, South Carolina (D)
DAVE CAMP, Michigan (R)
CHRIS VAN HOLLEN, Maryland (D)
JON KYL, Arizona (R)
MAX BAUCUS, Montana (D)
ROB PORTMAN, Ohio (R)
JOHN KERRY, Massachusetts (D)
PAT TOOMEY, Pennsylvania (R)

MARK PRATER, *Staff Director*
SARAH KUEHL,*Deputy Staff Director*

CONTENTS

OPENING STATEMENTS

WITNESS

ALPHABETICAL LISTING AND APPENDIX MATERIAL

OVERVIEW: REVENUE OPTIONS AND REFORMING THE TAX CODE

THURSDAY, SEPTEMBER 22, 2011

UNITED STATES CONGRESS,
JOINT SELECT COMMITTEE
ON DEFICIT REDUCTION,
Washington, DC.

The committee met, pursuant to call, at 10:08 a.m., in Room 2123, Rayburn House Office Building, Hon. Jeb Hensarling [co-chairman of the joint committee] presiding.

Present: Representatives Hensarling, Becerra, Camp, Clyburn, Upton, and Van Hollen.

Senators Murray, Baucus, Kerry, Kyl, Portman, and Toomey.

Chairman HENSARLING. The committee will come to order.

One of the preliminary announcements, the chair wishes to again remind our guests that any manifestation of approval or disapproval, including the use of signs or placards, is a violation of the rules which govern this committee; and the chair wishes to thank our guests in advance for their cooperation and compliance.

Today's hearing of the Joint Select Committee on Deficit Reduction is entitled Revenue Options and Reforming the Tax Code. We want to welcome our witness, Dr. Tom Barthold, the Chief of Staff for the Joint Committee on Taxation.

Dr. Barthold, thank you for your time. Thank you for your service. We look forward to your testimony. I suppose, more precisely, testimonies.

We may have set a Congressional first today with two panels and one witness. We will have our first testimony by our witness on business tax reform. There will be a round of questions by our members. Then we will have a second testimony by our witness on individual tax reform.

Members of the joint committee have agreed to limit opening statements to those of the two co-chairs. So at this time I will recognize myself for an opening statement.

OPENING STATEMENT OF HON. JEB HENSARLING, A U.S. REPRESENTATIVE FROM TEXAS, CO-CHAIRMAN, JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

Chairman HENSARLING. In last week's testimony regarding the drivers of our structural debt, we heard Congressional Budget Office Director Doug Elmendorf say that, although government revenues are certainly temporarily down, he expects them to again reach their historic norm of a little over 18 percent of GDP in short order. However, he reminded us that spending is due to explode to over 34 percent of GDP in the years to come, that principally driven by entitlement spending programs, some of which are growing at two, three, and four times the expected rate of growth of our economy.

As I have maintained since the first meeting of the Joint Select Committee, there are many actions that this committee can take that would be helpful in addressing our structural debt crisis. However, we simply cannot and will not succeed unless our primary focus is about saving and reforming social safety net programs that are not only beginning to fail, many of their beneficiaries but simultaneously going broke. If we fail to do this and choose to solely or primarily address our debt crisis by increasing the Nation's tax burden, I fear the consequences.

Former CBO Director Rudy Penner, in testimony before the Simpson-Bowles Commission, of which a number of us serve, stated, "the U.S. total tax burden, which is considerably below the OECD average, would be higher than today's OECD average by mid-century; and within a few years after that we would be the highest taxed nation on Earth."

Also appearing before Simpson-Bowles was former CBO Director and current Social Security and Medicare trustee Robert Reischauer, who stated, "the longer we delay, the greater risk of catastrophic economic consequences. The magnitude of the required adjustments is so large that raising taxes on the richer corporations, closing tax loopholes, eliminating wasteful or low-priority programs and prohibiting earmarks simply won't be enough."

Finally, when he served as CBO Director, Dr. Peter Orszag, in a letter to Budget Committee Chairman Paul Ryan, stated, "the tax rate for the lowest tax bracket would have to be increased from 10 percent to 25 percent. The tax rate on incomes in the current 25 percent bracket would have to be increased to 63 percent. And the tax rate of the highest bracket would have to be raised from 35 percent to 88 percent. The top corporate income tax rate would also increase from 35 percent to 88 percent."

So the ability, wisdom, and consequences of addressing our debt crisis through tax increases will continue to constitute a rigorous debate by our committee. My hope, though, is that we may be able to achieve rigorous agreement that fundamental tax reform, even just limited to American businesses, can result in both revenue from economic growth for the Federal Government and more jobs for the American people. Seemingly, both the President of the United States and the Speaker of the House agree.

Most Americans agree that there is something fundamentally wrong with our Tax Code when a small business in east Texas pays 35 percent and a large Fortune 500 company pays little or nothing. There is also something fundamentally wrong with our Tax Code when an American company pays 35 percent and its chief European competitor only pays 25 percent. We should seize the opportunity and correct this for the sake of both bringing in more revenues for economic growth and addressing our jobs crisis at the same time.

At this time, I will recognize my co-chair, Senator Patty Murray, for her opening statement.

[The prepared statement of Chairman Hensarling appears in the appendix.]

OPENING STATEMENT OF HON. PATTY MURRAY, A U.S. SENATOR FROM WASHINGTON, CO-CHAIRMAN, JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

Co-Chair MURRAY. Well, thank you very much, Co-Chairman Hensarling; and I want to thank our witness, Thomas Barthold, for taking the time to be here today, as well as all of our colleagues and the members of the public and the audience that are watching on television.

We all know the American people are looking at this committee with great optimism but also with real skepticism. They have heard the partisan rhetoric that has dominated our Nation's capital recently; and, quite frankly, they are tired of it. When it comes to this committee and its work, they don't care how it impacts one party's fortune versus the other. They don't care how it impacts one special interest versus another. Their only question to us is how will it impact their life. They want to know if we can help their spouse or family member or neighbor get back to work. They want to know if we can make a real dent in the deficit so their children are able to compete and succeed and can it be done in time for families that are losing faith with each passing day.

Answering those questions is going to take honesty from every member of this committee, honesty with one another and honesty with the American people about what it is going to take. It is going to mean looking at every part of our budget and realizing that there is spending that has grown too fast, job investments that still need to be made, entitlements that are expanding too quickly, and a Tax Code that has become riddled with corporate giveaways and special interest carve-outs for the richest Americans. But more than anything else it is going to take the shared realization that solving our deficit crisis and putting Americans back to work will mean taking a truly balanced approach.

Now, to this point, in Congress we have begun the process of addressing spending. In fact, the Budget Control Act that established this committee cut more than $1 trillion from our National deficit, and that was on top of caps to appropriations bills that had already been put in place.

But as the overwhelming majority of American families and economists and every serious bipartisan commission that has examined this issue has agreed spending cuts alone are not going to put Americans back to work or put our budget back in balance. We have to address both spending and revenue.

So I am looking forward to hearing from Mr. Barthold about the tax reforms and revenue this committee can explore. I am interested in hearing about the loopholes and tax expenditures my colleagues on both sides of the aisle have agreed are too often wasteful and market distorting but are options for broadening the base and lowering the rate, boosting the economy and bringing in additional revenue and about keeping our Tax Code truly progressive.

Revenue and the Tax Code is just one side of the ledger, but it is an important one, and it needs to be part of a balanced and bipartisan plan we owe it to Americans to come together on this committee and pass. I am pleased this committee has begun the hard work of negotiations over the last few weeks, and I am hopeful that we can come together and deliver the results that Americans deserve: a balanced plan that helps get our economy back on track, gives businesses the stability to hire again, and ensures that middle-class families and the most vulnerable are not bearing the burden of balancing our budget alone.

Thank you very much.

[The prepared statement of Co-Chair Murray appears in the appendix.]

Chairman HENSARLING. I thank my co-chair; and at this time, Dr. Barthold, I wish to yield to you for your testimony on business tax reform. You are recognized.

STATEMENT OF THOMAS A. BARTHOLD, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION

Mr. BARTHOLD. Thank you, Mr. Hensarling, Ms. Murray, and members of the Joint Select Committee. I thought I would use the time on this first panel to try and give you a very brief overview of the Federal tax system with an emphasis on business taxation under our system. My submitted testimony provides substantially more detail than, of course, I will be able to go into here.

I am going to concentrate on just a packet of slides that has been placed at each of your chairs.

If you turn to the first page of that, Figure 1 really just tells you that the Federal revenue system in the United States is comprised of five tax sources, of which the individual income tax is the largest, the payroll taxes are the second, corporate income tax is the third largest component, followed by a series of excise taxes and the estate and gift tax.

Figure 2 then documents for you that in fact this has been the case. This has been the basic structure of the U.S. tax system for many, many, many, many years. The one broad trend that you will see in Figure 2 is that employment taxes have grown in importance largely with the expansion of the Social Security system through—over the decades and Medicare, and the importance of the corporate income tax has declined since the post-World War II era.

Figure 3 really just documents I think a point that Co-Chairman Hensarling made that Doug Elmendorf presented to you a week ago, and this is sort of the history of Federal receipts as a percentage of the economy.

Looking over the next decade, there is some significant changes in the tax system scheduled to occur with the expiration of many current tax provisions after 2011 and then again after the close of 2012; and Figure 4 shows you projected revenues by source, the increasing revenues from the individual income tax, the payroll tax, and the corporate income tax, et cetera, for the debt next decade.

And just to scale that to the economy, Figure 7 provides the same information scaled to GDP.

Now, these prior charts that I have turned through very quickly divided the tax world into an individual income tax and a corporate income tax. But I think it is important for us to recognize that many business enterprises in the United States are not C-corporations, and so that means they are not subject to the corporate income tax. And in fact a significant amount of business income is taxed directly to the individual return.

And so what Figure 6 shows you is just the number of business entity types and how it has changed over the past 40 years or so, with Figure 7 providing particular detail on the growth of S-corporations and partnerships in comparison to C-corporations over the past 30 some years. As you can see in Figure 7, these pass-through entities, these alternative business forms, this includes State-chartered LLCs with which I know many of you are aware from your constituents, have become increasingly important in terms of the number of business entities.

But it is not just number of entities, of course, when we look at the tax system. It is the amount of revenue. And Figure 8 gives you a very quick look at the growth of net income reported by these entities and reported by C-corporations, again over the last 30 years. What this chart shows is the relative growth of non-C-corporate business income as a percentage of GDP.

The same information is really sort of emphasized in the projections that we are making for the coming decade. When you look at Figure 9, we project that the sum of income reported to sole proprietorships, to S-corporations and partnerships and other pass-through business forms will grow by 80 percent over the coming decade, comprising a larger and larger share of taxpayers' adjusted gross income.

Now, that said, it is also important to have a very good—I guess it will be very brief in this case—overview of how we tax business income in the United States. And the rules for taxing business income, whether it be through an S-corporation or a C-corporation, are really essentially the same. We look at the gross income of the enterprise less allowable deductions.

Allowable deductions include all ordinary and necessary business expenses such as salaries and wages, the fringe benefits for such things as retirement and health and other fringe benefits that employers provide employees, the cost of raw materials, advertising expenses, and an important expense for many business enterprises is the deduction for interest expense for borrowed capital. It is probably important to note in this case that interest expense is deductible to businesses, but dividend payments, another form in which capital invested is rewarded, is not deductible.

We provide rules for cost recovery for long-lived assets, referred to as the modified accelerated capital recost system makers. In other words, it accounts for the depreciation, the economic loss in value from long-lived assets.

Now, in addition, currently, there is a special deduction related to domestic production activities. This has the effect of lowering the effective tax rate on qualifying activities. Taxes on business income apply to the U.S. taxpayer's worldwide income wherever it is earned, but certain active income earned abroad may have its tax deferred until the income earned abroad is repatriated to the United States.

Currently, the top rate of tax for C-corporations, which applies to almost all large corporations, so just about any corporate name you can think of, the statutory rate is 35 percent. There are smaller—there are lower tax rates for smaller levels of income.

If you turn to Figure 12 in the packet before you it shows you a brief history of corporate income tax rates, and so you can see the 35 percent rate. The number inside the little bubble tells you the income level at which that rate becomes applicable, and so you can see both the bracket level as well as the rate and how that has changed since the mid-1970s.

Now, the co-chairman asked me to take a couple of moments and introduce the concept of tax expenditures and how they might be important, both in the context of business income and the individual income tax. The detailed presentation provides a large list and shows you some of the evolution of tax expenditures through time. Just to be clear, the notion of a tax expenditure is relative to sort of a theoretically pure income tax, what might be considered a special exclusion, a special rate, a special credit, or a special deduction.

And Table 5, the next page in your packet, shows you the largest tax expenditures as calculated by my staff colleagues for corporations encompassing the period 2010. We are projecting over 2010 to 2014, and you can see the 10 largest tax expenditure items are an estimate of those items.

One point I would like to note is that, although this list, this top 10 list, when you look in the detailed presentation, has changed over time, two items have been in the list of top 10 expenditures every time we have done the analysis since 1975, and that is some form of accelerated depreciation and the exclusion of interest on general purpose State and local debt held by business entities.

It has also been the case that the reduced rates for smaller levels of corporate income have been a feature of our tax expenditure analysis and our corporate tax system every year since the early 1980s. And generally also since the early 1980s one of the largest tax expenditures has always been either a deduction or a tax credit or you can take the sum of the two for research expenses.

I think at this point I have probably given you a very, very quick and rough overview, but it is probably time for me to turn it over to the committee so that you can ask specific questions, and I would be happy to answer any question.

Thank you very much.

[The prepared statement of Mr. Barthold appears in the appendix.]

Chairman HENSARLING. Thank you, Dr. Barthold, and we look forward to your second testimony as well.

The co-chair will yield to himself for the first round of questions.

On your Figure 3, Federal receipts as a percentage of GDP—as I understand it we, unfortunately, do not have these slides for our monitors—but what I appear to see is a chart that tells me that essentially since World War II that our Federal receipts as a percentage of GDP have been somewhere between 15 and 20 percent; and, as I understand it, the average is about 18, 18½ of GDP in the post-war era?

Mr. BARTHOLD. That is correct. Since 1950, the average is actually 17.9 percent; and since 1971 the average has been 18 percent. So it has been——

Chairman HENSARLING. Okay. So roughly 18 percent, and it has operated within a fairly, I guess, relatively speaking, narrow band.

It is also my understanding that during this same time period that we have seen marginal rates go as low as 28 percent and as high as perhaps 90 percent perhaps in the late 1950s, early 1960s, is that correct?

Mr. BARTHOLD. You are referring to the rates of the—the top rate.

Chairman HENSARLING. The top marginal bracket in the income.

Mr. BARTHOLD. And I actually have a—I think I have a nice picture of that for the second panel. But, yes, sir, you are correct.

Coming out of World War II and then during the Korean War, the top marginal Federal tax rate on the individual income tax—and this applied to ordinary income. There was a special treatment of income from the sale of capital assets—but was as high as 90 percent. It was then reduced to 70 percent in the Kennedy round of tax cuts in the early 1960s. The marginal tax rate individual income then was reduced further. In the mid-1970s, we made a split between earned and unearned income, with the top rate on unearned income remaining at 70 percent and on earned income dropping to 50 percent.

Chairman HENSARLING. Dr. Barthold, if I could—and I didn't see a chart here—but would the same correlation prove roughly true for corporate tax receipts?

Mr. BARTHOLD. We did have—one of the figures, Figure 2, sir, showed the Federal tax receipts as a share of total receipts.

Chairman HENSARLING. But not as a share of GDP.

Mr. BARTHOLD. I have a supplemental table.

Chairman HENSARLING. But to some extent does this not suggest that there are limits to the amount of revenue that are going to be gained by increases in marginal brackets if they have ranged from anywhere on the personal level from 28 to 90 percent. We still see roughly that revenues appear to be falling within this particular band. And so that was my question. And at some time I would like to see, if we could, that correlation of the corporate to GDP.

It is my understanding that—from data from the Joint Committee on Taxation—that roughly 50 percent of small business profits are taxed at the top two individual rates, is that correct?

Mr. BARTHOLD. I believe we have published that number, sir, yes.

Chairman HENSARLING. Okay. And one of your charts also shows that there has been a large increase, I believe, in—I am trying to find the chart—in the number of non-C-corp entities. I guess it is your Figure 6, perhaps.

Mr. BARTHOLD. Yes. In the packet before you, Figure 7——

Chairman HENSARLING. Oh, I am sorry. It is Figure 7. So certainly since the late 1970s there has been a huge increase in essentially what are known as pass-through entities?

Mr. BARTHOLD. That is correct, sir.

Chairman HENSARLING. So is it fair to say then that increases in the top two individual tax rates could impact—again, by your testimony—50 percent of small business profits—I don't know how many individual small businesses that is. Your Figure 7 would suggest that, again, we have a large number of pass-through entities that at least potentially could be impacted by that.

The next question I have really has to do with the pro-growth aspect that could be derived from some kind of fundamental business entity tax reform. I guess also to some extent your Figure 7 would suggest that tax reform in the realm of C-corps alone may prove problematic unless you deal with pass-through entities as well. Is that a fair——

Mr. BARTHOLD. Well, what I was trying to emphasize was that when we think of business income it is not just taxed in the Federal system through the tax on C-corporations, that there is a lot of business income that is reported on individual returns. But the concepts in terms of how we measure that income, the depreciation schedules, the treatment of research expenses, advertising expenses, are the same regardless of the entity cut.

Chairman HENSARLING. My time is about to wind down. I want to try to get in one more question.

I am curious about the type of model that JCT would use and what type of academic studies that have been researched regarding the potential pro-growth aspects of fundamental business entity tax reform.

I have seen a lot of information come over the transom. There was a 2010 Milken Institute Jobs for America report that concluded that taking our U.S. corporate tax rate to the OECD average of 25 percent could create 2.1 million private-sector jobs by 2019. I have seen a study by the *Journal of Public Economics* from a few years ago that found that a 10 percentage point reduction in U.S. corporate tax rate could boost GDP growth per capita by 1.1 to 1.8 percent per year. Can you give us a little bit more information concerning what model you use and how is it derived? What other studies have you looked at that might suggest to the committee the positive pro-growth aspects of fundamental business entity tax reform?

Mr. BARTHOLD. How long do I have, sir?

Chairman HENSARLING. Unfortunately, my time ran out. We will give you about 30 seconds, and then I will yield to my co-chair.

Mr. BARTHOLD. Well, I will give it very quickly.

We do multiple types of modeling for the members of Congress. The basic modeling that we do is based off of microsimulation models, and it is against the Congressional Budget Office macroeconomic baseline. And when we do that we look at many different changes in behavior in terms of choices that either individuals or businesses make. But for consistency in reporting to Congress and subject to the budget resolutions, we do not include a feedback effect in terms of this legislative package will increase or decrease the growth rate of the economy.

So for the past near decade now under House Rule 13 we have been providing, as part of House Ways and Means Committee reports on tax bills, supplemental information of macroeconomic analysis; and we have three different primary macroeconomic models that we use to emphasize different assumptions and to emphasize different features that people think are important in the macroeconomy. And in that analysis we look at the effect on changes in labor force participation rates, in savings rates, in cross-border capital flows, and changes in investment incentives and how businesses respond——

Chairman HENSARLING. Dr. Barthold, if I could, I am setting a poor example here. So at this time allow me to my co-chair, Senator Murray.

Senator KERRY. Mr. Chairman, I hope we are not being a prisoner of the clock where if any member asks a question—I am here to learn, and I hate to be truncating important data with such rigidity and ask that we allow the witness to answer.

Representative CAMP. Mr. Chairman, I would just say, having chaired committees, if we don't stay on the clock, we will never get through everyone's opportunity to have more than one chance at questioning. So I appreciate what the Senator is saying, but we are going to have to keep this moving. And we can always follow up with Mr. Barthold after. He is a government employee, and we can always talk to him after this hearing.

Chairman HENSARLING. We will have at least two rounds of questioning per member and two panels, so I appreciate that. And, again, I am not setting a particularly good example. And if other members wish to have the witness explore this particular question further they certainly can, but at this time allow me to yield to my co-chair, Senator Murray.

Co-Chair MURRAY. Thank you very much.

And thank you again, Dr. Barthold. I appreciate your testimony.

This hearing is divided into corporate and individual tax sections, but I really wanted to start with the key issue facing millions of Americans today, and that really is jobs.

We have heard a great deal about the negative impact the current economic situation and high unemployment rate has on the economy both in terms of demand for social services but also in reduced tax revenue. We have also heard this committee could have a positive effect on the fiscal situation of this country if we would support pro-growth policies in the short run, even if they result in greater spending, while promoting gradual and real changes to spending and revenues in the medium and the long term.

In terms of taxes, last week CBO Director Elmendorf testified that CBO had considered various tax proposals and weighed their effectiveness in stimulating the economy. He mentioned reductions in payroll taxes as among the most powerful, followed by expensing of investment costs for businesses, and then followed below that by just a little bit broader reductions in income taxes.

I wanted to ask you if JCT has performed a similar analysis of any kind and whether or not, if you did, your conclusions match or differ from CBO.

Mr. BARTHOLD. Thank you, Senator.

We have not tried to replicate work that the Congressional Budget Office did, but we have, in a number of different projects for the Ways and Means Committee and other members of the tax-writing committees, looked at some of the effects of payroll tax reductions expensing provisions. And so let me just address the way we approach that, and I think the Congressional Budget Office's approach is similar.

Expensing. Okay, expensing works to essentially reduce the cost of capital, reduce the cost of acquisition of new equipment by businesses. So it increases the after-tax return, makes it more attractive to make those investments. When we do our macroeconomic analysis, then we show that that leads to an increase in investment.

Now, what becomes important also in that analysis is what is the context of the overall legislative package. Is it just providing expensing relief for expensing of capital equipment for a large number of years? Is it offset in some way?

It is also important to think about how the Fed might react in terms of its policy for trying to moderate inflation. We don't—of course, right now, in the current environment, we don't think of inflation as a real—real problem. So as a general statement, yes, expensing can be a very powerful pro-investment incentive.

You mentioned payroll tax. We have looked at payroll tax. It usually is the effect that it depends are we talking—and this would be true of expensing, also—is it a permanent reduction in the payroll tax or a temporary reduction in the payroll tax? Is it offset in some way? So there is those same general questions.

But then the principle, of course, is that if it reduces the payroll tax and increases the after-tax wage that has two effects. There is a cash flow effect. There is a short-run stimulus in terms of aggregate demand, more money in my pocket. I can potentially spend more, but it also makes it more attractive for me to work longer hours.

Now, me personally, you already have me work fairly long hours, so that wouldn't be a personal effect. But it could mean that my wife might decide to, as she is currently not in the labor force, but maybe she would say, well, there is a better after-tax return to being in the labor force. And so labor supply would increase. And that is pro growth.

But it is important to think in terms of the overall legislative package as well. We can't just say because a package has this in it that automatically you get one result all the time.

Co-Chair MURRAY. Well, let me talk on corporate tax reform. As you well know, the U.S. corporate tax rate is 35 percent at the Federal level, 39 percent when the average State corporate tax is included. The average rate for other industrial countries of OECD is 25 percent, and only Japan has as high a rate.

I think most people do agree that such high tax rates make the United States a less attractive place in which to do business. Our corporate Tax Code also distorts business decisions making. Instead of making and improving their widgets or hiring new people, they spend too much time and effort devising business strategies aimed simply at tax avoidance. I think we know that all of that reduces the number of jobs that are created here at home, where we are all focused, and puts greater strain elsewhere on us in terms of government spending.

Companies in my home State have consistently been telling me that they care less about keeping a particular tax expenditure, even when they benefit from it, than having a predictable system of taxes with lower marginal rates. Right now, they don't necessarily want to game the system to pay a lower rate. They will use every loophole that is available to them, obviously. But they tell me that they would rather focus their efforts on making things and selling products around the world.

So I think we all agree that our corporate Tax Code needs substantial reform, and I think it is important to do both the individual and the corporate side together because a significant number of businesses operating as pass-through entities pay taxes on the individual side. So to ensure the competitiveness of U.S. business it is important, I believe, to coordinate reforms for individual and corporate taxes; and I want to ask you if you agree that there are advantages to doing more comprehensive tax reform, as opposed to just looking at the corporate side.

Mr. BARTHOLD. In terms of business income, Senator, I think that was the point I was trying to emphasize in my brief run-through. It was to note that there are businesses that are organized as C-corporations.

I should note when you look at the supplemental material that I provided, while I have said there are a lot of non-C-corporate businesses in terms of assets, large C-corporations own the vast majority of assets and earn the vast majority of business taxable income.

Now, that said, I have noted that non-C-corporate entities are growing in number, and the income attributable to those entities is growing relative to the overall tax base. Because we define business income the same way, if we are looking—I think we should not look just at corporate reform but business income reform. And it would from a practical point of view, sort of a practical legislative point of view, from sort of the legislative weenie aspect, it would be very difficult to wall off a number of provisions and say we will have one set of rules if you are this type of entity and a potentially very, very different set of rules if you are another type of entity. Because then we would have to double back and have rules to keep people from—to restrict their entity choice, and that would be a bad outcome, to restrict entity choice.

Co-Chair MURRAY. Okay. Thank you very much. My time has expired.

Chairman HENSARLING. The co-chair now recognizes Senator Kyl of Arizona.

Senator KYL. Thank you.

Dr. Barthold, just to follow up on one of Senator Murray's questions with regard to the effect of short-term payroll tax deduction policy, in your studies did you find any evidence that either the payroll reductions—well, just take the most recent, but if you want to go back to the Bush administration, if you can recall that as well—did that have a stimulative effect on the economy and was it responsible for any job creation? Obviously, we had job reductions during that period of time. Did the temporary aspect of it reduce its effectiveness and was the need for people to deleverage such that, rather than spending a lot of that money, they ended up paying off debts or saving the money? Were those possible effects that reduced the effectiveness of that temporary policy?

Mr. BARTHOLD. Senator Kyl, just to be clear, you are talking about the tax rebates under the Bush administration.

Senator KYL. There was a tax rebate under Bush, and then more recently we had a payroll tax one-year policy, which some would like to see extended.

Mr. BARTHOLD. Since we have done some work recently on the payroll tax reduction, let me try and answer your question by addressing that.

As I think I noted to Senator Murray, there is really sort of two aspects to that in terms of macroeconomic analysis. An increase in take-home pay can have a stimulative effect. It increases the taxpayer's cash flow and the consumer can consume more, if it is short—and that is true in the short term. There is mixed empirical results on whether if someone just has a very short-term increase in pay how much is saved as opposed to how much is spent. So there is an effect in terms of the efficacy as opposed to a long-run change, but there still is that short-run demand effect.

Now, a second aspect that we talked about is, well, what is the supply effect, the labor supply response? To a short-run policy you would not expect a dramatic labor supply response, because labor supply decisions tend to be a little bit longer-run decisions. Now, we had used one of our macroeconomic models to analyze a proposal to extend by 1 year a payroll tax reduction comparable to the one that is in present law——

Senator KYL. Could I just interrupt you? Rather than speculating about what might happen in the future if the current policy is extended, what is the evidence of what has happened during the policy that is in effect now?

Mr. BARTHOLD. Well, there is no academic study or solid empirical evidence right now. I mean, there is only sort of casual empiricism, because the data is not available. One problem with economics and analyzing the effects of policies is it sometimes takes 2, 3, 4 years to get the data and do a good analysis. So I don't have a good answer for you in terms of the effect of the policy that is currently in place right now.

Senator KYL. So given that there are some of these other factors, temporary versus permanent, short term versus longer term, and obvious deleveraging that is going on in the country right now, all of those are factors that you would have to put into your analysis about what potentially might happen in the future.

Mr. BARTHOLD. As I had noted, it is important to think of the overall context of the legislative package. You can't just say because it has this one piece in it that you get a guarantee.

Senator KYL. Cause and effect is complicated in the economy.

Mr. BARTHOLD. Well, there is many—a number of the other things that you mentioned will also affect business decisions and potentially employment decisions.

Senator KYL. Could I—we are all going to complain about the fact our time is short.

I think I have got some yes-or-no questions, and I would like to ask you if you could just answer these true or false or yes or no. Let me just ask you about some general economic principles or statements. And these are, as you said, generally speaking, and then you qualified some of the other things that you said, and I totally appreciate that. But, generally, there is a positive relationship between economic growth and jobs, true or false?

Mr. BARTHOLD. Certainly.

Senator KYL. Right. True.

There is a positive relationship between economic growth and resulting revenues to government.

Mr. BARTHOLD. That is also true, sir.

Senator KYL. There is a positive relationship between economic growth and reduced Federal spending on need-based programs.

Mr. BARTHOLD. Well, that will depend—I have got to give you a qualified one there, because it depends on what is happening in terms of where income is being earned.

Senator KYL. Fair enough.

There is a positive relationship between economic growth and deficit reduction.

Mr. BARTHOLD. Well, that will depend on a lot of——

Senator KYL. Again, if we don't go spend all the money, all else being equal.

Mr. BARTHOLD. That would be true, sir.

Senator KYL. Right.

Senator Murray was saying tax policy affects economic growth.

Mr. BARTHOLD. That is what our macroeconomic analysis is trying—it tries to provide members with information about how it might or when it might not.

Senator KYL. It may do it in a lot of different ways.

The official revenue estimates from the Joint Committee on Taxation account for behavioral responses of individuals but not larger economic growth effects. Is that a fair way to state your revenue tables?

Mr. BARTHOLD. That is fair shorthand. We work against the Congressional Budget Office macroeconomic baseline and receipts baseline, and so we do not assume that the large economic aggregates of total income, total investment, employment, and inflation are altered.

Senator KYL. Right. But you also said earlier, I think in response to Representative Hensarling's question, that the Joint Committee on Taxation is capable of providing estimates of growth effects since it provides this analysis to the House. But these growth effects are not incorporated in the official score of a proposal, is that correct?

Mr. BARTHOLD. It certainly is the case they are not part of budget rules and budget scorekeeping. The information that we provide is a range of outcomes that reflect sensitivity to different assumptions. But, yes, we do provide that information to the House under Rule 13.

Senator KYL. Right. Where is our light or timer? So I am over. Sorry. Dadgum, I had a really good closing question.

Chairman HENSARLING. The Senator from Arizona will have another opportunity to ask that question.

At this time, the chair will yield to Congressman Becerra of California.

Representative BECERRA. Thank you, Mr. Chairman.

Mr. Barthold, good to see you again just 24 hours later. We saw you in Ways and Means, and we thank you for that testimony as well.

Let me ask if we can get your Table number—I am sorry—yeah, Table number 5 from your charts. And I would like to talk a little bit about the tax expenditures, at least those in this chart that apply to corporations.

Expenditures seem to have quite a bit to do with the actual taxes paid by a company. And so while we hear about the corporate tax rate in America being around 35 percent, if you are able to qualify for some of these tax breaks, these tax expenditures, you can reduce what you effectively pay to the Federal Government in taxes so that your actual tax payments will be less than at a 35 percent rate.

And, actually, that is not the chart I am referring to. It is Table, not Figure 5. So if we can go to the—it was your last chart. That is correct. You have that one. Just so we get it correct on the screen. It should be the very last chart I believe you presented.

Mr. BARTHOLD. In the handout that I gave you, it was the last item before part two.

Representative BECERRA. Right. I am not sure if folks can see that clearly.

But I wanted to just move into that a little bit because, quite honestly, through the Tax Code we select winners and losers on the corporate side in terms of income taxes; and I suspect we will see with regard to tax expenditures these same kinds of tax breaks that are on the individual side of the Tax Code that we select winners and losers as well. And if I could ask a question. If we were to remove, for example, the first tax break that you list, a deferral of active income of controlled foreign corporations, $70 billion over a 4- or 5-year period, who would lose?

Mr. BARTHOLD. For the benefit of the committee, the particular tax expenditure line item that Congressman Becerra is referring to, deferral of active income of controlled foreign corporations, relates to the point that I gave in my overall testimony that the United States taxes business income on a worldwide basis. But in the case of active income earned abroad the taxpayer may elect not to repatriate that income, and if the taxpayer so makes that election the tax is deferred until the taxpayer chooses to do that.

So if the Congress were to decide to repeal deferral, just to take shorthand, it would mean that the income would all be taxed at the current statutory rates. Since this is about income that is earned abroad by corporations, we are largely talking about U.S.-headquartered multinational corporations, and so it is the income that is earned on overseas investments and overseas sales by those corporations.

Representative BECERRA. And just going through the list, you have a tax credit for low-income housing. I would assume if we were to remove that tax break the $27 billion that goes to those who take advantage of that tax break probably affects the housing market. And if you were to go to the expensing of research and experimental tax expenditure, where it is $25.5 billion, that it is those companies that do research and experimentation that can claim on their taxes that they did certain research or experimenting activities and therefore get to reduce their tax burden.

So we could decide, based on what we eliminate or leave, who becomes a winner and who becomes a loser. And so we have to be very careful how we do this, because we could influence actions of a lot of important companies that do business here and maybe do business elsewhere but are American companies. And so how we decide to reform the Tax Code could have a major impact.

Obviously, those are all—the list of those different types of tax breaks list a good chunk of money that we don't collect because we give the tax break to those individual companies that could qualify. So as we talk about making changes we could pick—we could end up selecting the winners and losers.

Let me ask another question in the brief amount of time that I have with regard to tax collection. We know that there is owed tax money that is not collected. In some cases, it is not intentional. People make a mistake on their filing. In some cases we know, and we have had cases where it has been proven, that people intentionally try to avoid paying their fair share of the taxes.

There are estimates about how much we don't collect in taxes that is owed. I don't know if there is any recent estimate, but I know there was one from about 10 years ago that was somewhere around $345 billion or $350 billion. Has there been any update to that estimate of uncollected taxes?

Mr. BARTHOLD. The research division of the Internal Revenue Service runs what they call the National Research Project, and they are working on updating those estimates. But the estimates that you cite of about $350 billion in terms of what is referred to as the tax gap per year I think are the most recent, but they are a couple of—at least a couple of years old, sir.

Representative BECERRA. And with my time expiring I will see if I can explore this a little bit more when we come back and talk again about the individual income tax. So thank you very much for your testimony.

Mr. BARTHOLD. You are welcome, sir.

Chairman HENSARLING. The co-chair now recognizes Congressman Upton of Michigan.

Representative UPTON. Well, thank you, Mr. Chairman.

And thank you, Mr. Barthold, for not only being here with us today but, as I understand it, you will be with us a number of times in the days ahead answering some questions, so I appreciate that flexibility.

We know that the U.S. corporate tax rate is the second highest that there is. And as we look back at the size of the top 20 companies in the world 50 years ago, 17 of them were U.S. based; in 1985, 13 of the top 20 companies were in the U.S.; and, today, it is about six.

The companies that I talk to, particularly in Michigan and before this committee here in Energy and Commerce, one of the things that they talk quite a bit about is certainty in the Tax Code. There is a lot of—and there has been—discussion, working with Chairmen Camp and Baucus as well, to hear their comments from the many hearings that they have had,. But the R&D tax credit, which stops and starts and stops and starts, is a real frustration. Accelerated depreciation has been a bipartisan idea for a long time to encourage investment here in this country and export products overseas.

How would changes in these two, accelerated depreciation and R&D, and maybe moving the dials a little bit in terms of increased deductions or whatever, how would those help us with investment in jobs in this country? What would you encourage us to do as you have examined the Tax Code? Have you done studies along these lines?

Mr. BARTHOLD. Well, Congressman, let me refer back to the example that Senator Murray raised and you said that Doug Elmendorf broached with you a week ago; and that is, what does expensing do?

Well, expensing is one form of accelerated depreciation. It is kind of like super-accelerated depreciation. Accelerated depreciation methods, again, they go to the cost of capital for business. Even from a sort of simple cash flow method it means that you have more cash available after tax from being able to recover more of your cost sooner. Or if you look at it in what economists refer to as the user cost of capital model looking over the lifetime of the asset, by having costs reduced early over the life of the asset, as opposed to later over the life of the asset, the present value of the returns to the asset are increased, so it makes it a better investment.

So accelerated depreciation is a policy that encourages investment in the United States.

Similarly, you mentioned the research credit and expensing of research activities. From sort of a—from a——

Representative UPTON. But do you have studies showing that if we did X or Y it would allow companies to do more investing here, allowing more people to work and pay taxes, a whole number of positive things for the economy? Is there a laundry list of things that can help us?

Mr. BARTHOLD. The joint committee staff responds to members' legislative initiatives, so we don't have really many formal studies that say do this as opposed to do that.

Now, we have—in some of our macroeconomic work that we have undertaken to provide supplemental information to the Ways and Means Committee, we have looked at the role of expensing, we have looked at the role of reduced corporate tax rates, some of the same points that I made to the Senator earlier.

There are a number of academic studies which we review to help inform our work, both in terms of our conventional estimates and our macroeconomic work, on the impact of incentives for research, on the impact of accelerated depreciation; and most of the economic findings are that there is an effect. There is differences of opinion as to how large the effect is. But the incentives generally are, as the theoretical discussion would suggest, that they are pro-investment, or pro-research in the United States.

Representative UPTON. Do you have any studies that show if we increased the capital gains rate from the current 15 percent, what it would do to capital investment by companies if we raised it to 20 or 25 percent?

Mr. BARTHOLD. Well, again, Congressman, no study per se on point. And you are asking about what would be the macroeconomic effect of that change.

So to walk through, that is tax on capital gains affects the—let's think of it on corporate stock—the shareholders after-tax return to investment. So there is a couple of ways in which the shareholder gets returns through investment. There is a tax on dividends. There is——

Representative UPTON. But the company itself, if it——

Mr. BARTHOLD. Well, capital gain—remember, the capital gain, of course, relates to the change in the value of the company shares which can occur sort of two primary ways. The company is very profitable, and so its income earning potential increases, and so the value of the stock is, over the longer haul, sort of the discounted value of the potential net income of the company. So if the company is successful and its income goes up, the value of the stock should go up. And a higher tax on capital gains at then the individual level would say the return to me saving and putting my money in equities as opposed to maybe putting my money in the bank or buying debt instruments or some alternative investments makes that after-tax return a little bit less, so I may choose to do other things.

So our macroeconomic analysis tries to look at the more general portfolio effect of what are the different saving options that individuals have; what does this do to the taxation of the overall kind of net return to saving.

Net saving is important in the macroeconomy, because that is really the wherewithal to invest. Those are the funds to invest. And we think that taxpayers do respond to the net return to saving, and if the net return to saving is reduced there will be a little bit less saving. That works through the macroeconomy. It is hard to sort of trace one particular aspect of that saving return, but that would be an important aspect.

Chairman HENSARLING. The time of the gentleman has expired. The co-chair will now recognize Senator Baucus of Montana.

Senator BAUCUS. Thank you, Mr. Chairman. I would just like to just address a bit this point that the top two rates, if they were raised, hurt small business. It is true, as has been mentioned already here today, that 50 percent of small business income is subject to the top two rates, but it is not true that 50 percent of small businesses, employers, are subject to the top two rates. In fact, only 3 percent are. And it is also, isn't it true, Mr. Barthold, that again only 3 percent of taxpayers with pass-through business income are subject to the top two rates; is that correct?

Mr. BARTHOLD. I believe that is a statistic that——

Senator BAUCUS. About 3 percent of taxpayers, not 50 percent, but 3 percent of taxpayers?

Mr. BARTHOLD. There are a large number of businesses, pass-through businesses, the owners of which, so the recipients of the pass-through income, who are not in the top tax brackets.

Senator BAUCUS. And in addition, isn't it true that about half of the 3 percent are taxpayers like bankers or celebrities that earn large salaries and don't employ anybody but really invest a small portion of their income in publicly traded pass-throughs like, say, a REIT?

Mr. BARTHOLD. Could you——

Senator BAUCUS. About half of that, half of the 3 percent are people who don't really employ people, but they are businesses that invest their income?

Mr. BARTHOLD. Certainly a number of the recipients of what you would consider active business income are the passive investors in those businesses. That is certainly——

Senator BAUCUS. I was trying to make the main point that only about 3 percent of pass-through income is affected by the top two rates.

There is a lot of talk about corporate tax reform, which I think it is good. In general the talk is we need to broaden the base, lower the rates, et cetera, and there is a lot of talk about lowering the top corporate rate to make it more competitive with other countries in the world, and that is good, but a lot of that would include eliminating, reducing many of the tax expenditures. Some will point out that the effective U.S. corporate rate is roughly comparable to the effective tax rate of other companies in other countries.

I want to ask you if that is generally true, that our effective tax rate is competitive with other countries?

Mr. BARTHOLD. It is not always clear what some people mean by the effective tax rate, what some——

Senator BAUCUS. After you deduct all the credits, exclusions, and all that.

Mr. BARTHOLD. Well, but there is also—it is after you deduct and it is a little bit over what time period. So I have seen the studies that you cite that say that, and so what you say is true that there are studies that say that, but part of what they are calculating is if you look at book reported income and book reported taxes of U.S. public corporations, they would not include in the taxes the taxes that are deferred abroad on what they consider income——

Senator BAUCUS. Right. I don't want you to misunderstand. I am for going down this road. I think we should lower our corporate rates very significantly. However, I have also seen other data that show that today the different industries in the United States enjoy, there is a big difference among which industries in the United States enjoy tax expenditures compared with other industries. It is a big variation. For example, the manufacturing industry and the real estate industry take much better use of, because they are available, of the tax expenditures than, say, the services industry, the retail industry.

So I am really trying to point out that if there were very significant changes, base broadening, and rate lowering of the corporate tax income that there would be big dislocations. Some industries would be hurt a lot compared to others, and some would benefit compared to others, and I think it is only important for us to know which those industries are and if we go down this road then to know what the transition rules should be to affect these different industries and then try to decide which of these industries are really more important for jobs and growth in America compared to others.

Now, we don't want—nobody likes to pick winners and losers here, but it may be that some of these industries do provide more jobs than some others, and I think it is important that we note what they are. So it would help me, anyway, if Joint Tax could come up with some kind of a study that shows which industries benefit the most today compared to those that don't.

Mr. BARTHOLD. Senator, I will follow up with you and your staff. I think, as you know from work that we have done for you in the past, I mean, we do identify certain features of the Tax Code by the primary industry of the taxpayer, and we have done some analysis for you in the past. We can do some more.

Senator BAUCUS. In part I am just trying to point out, this is not an easy undertaking, corporate tax reform. It takes time, and often when we go down this road it is more complicated than we think, and there are unintended consequences of major changes that we might otherwise make. It is important that we think through what the intended consequences are to try to avoid some of the unintended consequences.

My time's expired.

Chairman HENSARLING. The co-chair now recognizes Senator Portman of Ohio.

Senator PORTMAN. Thank you, Mr. Chairman, and I appreciate Chairman Baucus' comments, both saying that he supports heading down the road of lowering these rates, which are high relative to our global competitors, but also the fact that this requires hard work, and I am hoping this committee can roll up its sleeves and with his guidance and Chairman Camp's guidance get into some of these tough issues because he is right, this is complicated.

I will tell you that as recently as yesterday a CEO of an Ohio manufacturing company that does business overseas came to me and said, I am at the point that I believe that a lower rate is a better deal for me and my company than me taking advantage of many of the current preferences that are in the code for industrial companies, as the chairman said, and that would be consistent with what Co-Chair Murray said earlier about companies in her State that have come to her.

So this is a path, I agree with Chairman Baucus, worth us pursuing, and with the extraordinary procedural opportunities before this committee, I am hoping that this committee will use this opportunity.

I have two sort of simple questions that I have about the tax reforms that we have been discussing today. One is, you know, what should the tax burden be on the economy? And I think that is sort of the fundamental question that we need to answer in this committee, and that goes right to your testimony, Mr. Barthold, because in Figure 3 you talk about the 18 percent historical average, percent of GDP of taxes, and then in Figure 5 you talk about what is going to happen over the coming decades, and you see that percent of GDP in Figure 5 going up significantly from 18 percent.

So, one, we need to figure out what is the right burden on the economy, and that I think is properly reflected as the percent of GDP, and then the second question is really the fundamental one everyone has been asking today, what is the best way to collect those taxes. I suppose some would say it is a VAT tax or maybe some other consumption tax. I don't think this committee has the time and ability to get into that level of reform, but I do think that there has been a lot of work done by Chairman Baucus, Chairman Camp, and others to look at this to know that there is a way to lower rates and broaden the base, and best is in the eye of the beholder I suppose.

Some have talked about distribution and fairness, some have talked about efficiency, the cost of compliance, which is really a separate issue from the impact on economic growth, although it relates to it, and then finally, you know, what is the most efficient way to allocate resources and what impact will that have, as Mr. Barthold has talked about today, on economic growth, and that is the sweet spot for this committee, as I see it, you know, how do we do smart tax reform that, one, does not provide additional new burdens on the economy that make an already weak economy even weaker, and we can't do that. President Obama has said that, President Clinton apparently said that today somewhere, but the second one that is smart so that it does generate more economic activity, and as a consequence of that more efficient Tax Code that generates more economic activity, generates more revenue.

So it is a consequence of the fact that it does have an impact on economic growth. This feedback has to be measured, and this is one of the frustrations that many of us have had over the years, is that although there is plenty of economic analysis out there showing this is true, and you have talked about it this morning, Mr. Barthold, it needs to be reflected somehow and measured so that good policy can result, and so in the short time we have on this committee, I am really hoping that we will be able to have those measurements and we will be able to, with the Congressional Budget Office, be able to show what the impact is of various tax reform proposals.

On the corporate rate, since we are talking about that now, we don't collect as much revenue as we should, due in part to the complex, inefficient, and loophole-ridden Tax Code we have got, and therefore most economists agree that fundamental corporate tax reform is going to produce more economic growth, and therefore, again, as a consequence, more revenues.

Can you just quickly go through how you can give us that information? Let me try to summarize what I heard you say earlier, and you can correct me. One, you have a standard model, and that model will provide us with some behavioral changes. We talked earlier about allocating resources more efficiently under a Tax Code that makes more sense, and individual and firm responses I understand you can incorporate within your standard model. Is that correct?

Mr. BARTHOLD. Our conventional estimates always include behavioral responses of many different types, sir, yes.

Senator PORTMAN. So we will get some feedback through your standard modeling, your conventional modeling. Second, you have a macroeconomic effect you now do, you talked about House Rule XI, and you provide that as a supplemental analysis to Chairman Camp of Ways and Means Committee. That macroeconomic analysis you do is something that is made public, correct?

Mr. BARTHOLD. It is included in the House committee reports on a reported bill, yes, sir.

Senator PORTMAN. And can you extrapolate from the macroeconomic effects that you are already studying—you have the model to do it—as to what the revenue feedback is going to be from, say, an increase in GDP?

Mr. BARTHOLD. Senator, we have reported, as part of the reports, changes in GDP, changes in employment, changes in investment, and changes——

Senator PORTMAN. Labor market?

Representative BARTHOLD [continuing]. In revenues from the resulting growth, again across a range of sensitivity assumptions, to give sort of the breadth of possibilities.

Senator PORTMAN. And labor market as well?

Mr. BARTHOLD. Employment, yes, yes, sir.

Senator PORTMAN. And so you have provided revenue estimates from those changes——

Mr. BARTHOLD. No, not revenue——

Senator PORTMAN [continuing]. In GDP and labor market?

Mr. BARTHOLD. No, I wouldn't want to call them revenue estimates. You could, I guess, you know, think of taking the next step and saying what is the feedback that was identified and add that back in.

Senator PORTMAN. So it could be done?

Mr. BARTHOLD. Chairman Camp of Ways and Means held a hearing yesterday, as Mr. Becerra had noted, and they discussed some of those issues, and I can provide the members here later with copies of that testimony. We gave some examples of some macroeconomic——

Senator PORTMAN. But Mr. Barthold, let me just say because my time is short, I know this committee would be very interested in knowing what that feedback is, and again you all do great analysis. We need to be sure we have that analysis that in the real world there is going to be changes that will result in revenue changes, and we need to be able to consider that, and we have to do it in a short period of time here, which is several weeks.

I know my time has expired, but let me also just put on the table, you also do a compliance analysis, and if you go from a compliance, say, 88 percent compliance to 89 or 90 percent compliance, that can have huge revenue changes, and then you do a complexity analysis which can also impact that; is that correct?

Mr. BARTHOLD. We do a complexity analysis. We are trying to study doing more comprehensive compliance analysis.

Chairman HENSARLING. The time of the gentleman has expired. The co-chair now recognizes Congressman Clyburn of South Carolina.

Representative CLYBURN. Thank you very much, Mr. Chairman. Mr. Chairman, it is my humble opinion that the overarching mission of this committee is to find common ground. Now, recently, the House Republicans released a jobs plan in which they referred to the Tax Code, and I quote, has grown too complicated and cumbersome and is fundamentally unfair. I could not agree more with this assessment. I think it is unfair that wages are often taxed at a higher rate than investments, I think it is unfair that the wealthiest among us get the most tax breaks, and I think it is unfair that a number of top corporations who are making record profits pay more to their CEOs than they do in taxes.

Now, as we pursue common ground, I want to know whether or not you would agree that the number I have seen is that those people making over a million dollars a year, that is like three-tenths of 1 percent of our entire population.

Mr. BARTHOLD. That figure sounds correct, Congressman.

Representative CLYBURN. Okay. If that figure is correct, and you say that it is, I think the question before us today, one of the questions is, is it fair to value wealth more than we value work? Because if we are willing to say that our Tax Code reflects our value system, our Tax Code seems to currently put a greater value on wealth and dividends than it does on work and wages. Now, is it class warfare to seek some equity in the Tax Code? That is my question. Do you think it is tax warfare? I am not asking—I don't know whether it is or not, but do you think?

Mr. BARTHOLD. Well, Congressman, I don't offer an opinion on that sort of a question. I try and my staff tries to provide information to Members such as yourself so that you can make appropriate judgments for the American people.

Representative CLYBURN. Thank you. That is fair. Let me ask something about—I am a great believer that there is something that we ought to pursue in this committee called, we may call it consumption tax, we may call it a value-added tax, I don't know what we might want to call it, but isn't it true that every major economy with which the United States competes really funds their government through consumption taxes?

Mr. BARTHOLD. All the Western European economies have individual income taxes, payroll taxes, corporate income taxes, some excise taxes such as we do, some estate or inheritance taxes such as we do, and in addition they all have a value-added tax.

Representative CLYBURN. Well, then, if CRS's estimates are correct that a value-added tax could be levied on a taxable base of $8.8 trillion, if we exempt food, health care, housing, higher education, and social services, that would leave a taxable base of around $5.1 trillion. Do you agree that a VAT is a viable option?

Mr. BARTHOLD. Through time, Congressman, a number of Members of Congress and, in fact, the Ways and Means Committee in the late 1990s held a series of hearings. They asked us to explore a number of issues related to value-added taxation. Our staff has identified for Congress a number of policy issues for them to think about. Conceptually, legislatively, yes, it would, you know—it is a viable option to create a VAT. It would take a lot of work, a lot of decisions by the Members, and a lot of technical work to get the law up and functioning for taxpayers.

Representative CLYBURN. Thank you. In the 50 seconds I have got left, let me be clear, when we talk about a 35 percent corporate tax rate in this country and comparing that with the rates in other countries, we really are not comparing apples to apples, we are actually comparing our rate to countries that have a value-added tax?

Mr. BARTHOLD. As I noted, sir, most of the——

Representative CLYBURN. In addition.

Mr. BARTHOLD. Those countries do have a value-added tax in addition to their corporate tax.

Representative CLYBURN. Thank you very much. I will yield back my 16 seconds to someone else.

Chairman HENSARLING. We thank the gentleman for yielding. The co-chair now recognizes Congressman Camp of Michigan.

Representative CAMP. Thank you, Mr. Chairman, and thank you, Mr. Barthold, for your testimony yesterday on economic models for analyzing tax reform.

Figure 1 of the handout that you gave us shows the Federal receipts by source, and I just want to underscore, it shows more than 47 percent of those receipts to the Federal Government come from individuals, and only just over 8 percent come from corporations or what we call C corporations.

Mr. BARTHOLD. That is correct, sir.

Representative CAMP. Corporate income. And in Figure 4 in your projection of Federal revenues to come, which I think goes through 2021, it basically shows receipts from corporations being flat going forward, but yet revenue from individuals is shown to be increasing over time. Is that a fair statement of the two charts? I see another line on individual——

Mr. BARTHOLD. It is a little bit a matter of scale. You can see the green line, the corporate tax, does increase.

Representative CAMP. Slightly.

Mr. BARTHOLD. As expensing. It is currently slightly lowered by the fact that we have had bonus depreciation followed by expensing.

Representative CAMP. But the point is the individual is going to go up at a faster rate, receipts to the Federal Government, projection of Federal revenues to the government is going up greater from individuals than from corporations?

Mr. BARTHOLD. Yeah, I believe that is consistent with our projection.

Representative CAMP. And some of that is related to your testimony about the number of entities that are organized as pass-throughs, which pay taxes as individuals, so some of that is business activity that you are seeing increase in that chart, and isn't the United States somewhat unique that so much business activity takes place in the form of pass-through entities, S corporations, LLCs, partnerships, and isn't it fair to say that other countries do not have as much business activity taking place in a pass-through form?

Mr. BARTHOLD. These sorts of entities are more prevalent in the United States, but I am not expert enough in all the other countries to make a blanket statement.

Representative CAMP. All right. But corporate reform alone would then leave out many employers, leave them out of the equation because of the way that business activity is organized in the United States. So as we compare around the world, we need to understand that.

Moving to corporate rates, which are a major factor in where businesses decide to invest and to locate, it has been said by yourself and others we have this high statutory rate, and with capital being increasingly mobile, it has become a much more important factor. The high corporate rate makes investment and job creation in the U.S. less likely as we compare around the world, and if you look particularly at Canada, who is certainly a key ally of ours but also a key trading partner, one of our largest trading partners, but when it comes to trade, they are one of our key competitors, you look in 1990 they had a 41½ percent corporate rate, in 2010 it was

29, 2011 it is 16.5, in 2012 their corporate rate is going to go to 15 percent.

Now, we have a high statutory rate, second highest in the world, in the OECD countries, but we have a number of expenditures, tax expenditures that then lower that rate, and that affects different sectors, as Chairman Baucus pointed out, in different parts of our economy in different ways, but aren't these other nations getting to their lower rates by eliminating these tax expenditures around the world?

Mr. BARTHOLD. Some of the other tax reforms that I am familiar with have made trade-offs of that sort. For example, Germany has lowered their statutory rate, and they made the, one of the trade-offs they made was to lower their statutory rate while lengthening cost recovery, cost recovery periods. That was a policy choice that they have made. So the reduction in special provisions I think as reported by the OECD, that they have noted that that has been a factor in a number of worldwide tax reforms.

Representative CAMP. And as Chairman Upton pointed out, the number of large companies headquartered in the U.S. has declined as other economies have emerged or changed their tax policy, and we are finding that many major employers are located in other countries rather than the U.S.

Mr. BARTHOLD. It is certainly a fact that worldwide large corporations, that fewer of the top 50, the top 100 are U.S.-headquartered companies. So I am sure there is many factors that have accounted for that, you know, the growth of other countries, but that is certainly a fact, sir.

Representative CAMP. The other factor we face as a nation is the number of expiring business tax provisions, and can you comment on how that has grown? I mean, I remember as they used to call it the Rostenkowski 13, the 13 business tax expenditures that were expiring. How many do we have now that expire on a regular basis? Do you have that?

Mr. BARTHOLD. Okay, well, we actually, as I know you are familiar, Mr. Camp, we publish annually a list of expiring Federal tax provisions. Just for the other members, and I will get a copy of this for all the joint select committee, it is our document JCX2-11. We have done this annually for more than a decade, and it used to be a lot thinner publication. I think we are up to expiring within the next 2 years 150 or more different provisions of law.

You know, it certainly creates uncertainty both at the individual level and at the business level of what is the law going to be next year, what is the law going to be 2 years from now, and obviously there are a lot of important policy choices that go into—that the members have to face as well.

Representative CAMP. Thank you, Mr. Barthold.

Chairman HENSARLING. The co-chair now recognizes Senator Kerry of Massachusetts.

Senator KERRY. Thank you very much, Mr. Chairman. I want to focus later on some of the tax expenditures probably more on the individual, but I think it is important to note that 80 percent of all of the money the Federal Government raises in taxes, 80 percent of it goes out right back into tax expenditures. Only 20 percent of what we raise actually goes into things we spend, pay for at the

Federal level. 95 percent of those tax expenditures, 95 percent of that 80 percent goes to 10 top expenditure items.

So I have got a lot of questions about the efficiency of that, among other things, and the choices that are made, which I think we have to look at, but I want to just say at the outset I second powerfully what Senator Portman said about our opportunity here, given the mandate and given the structure of this committee and its presentation to the Congress to take advantage of this to try to get that sweet spot which he talked about, which is really simplifying this, putting in place the most efficient choices that will drive our economy, that therefore will raise revenues and help us deal both with the deficit as well as jobs at the same time, and I think that is the key thing here.

One of the things I would like to focus on very quickly is just this question, simple question. We hear a lot about the top tax rate with respect to corporations, and, yes, it is the second highest statutory rate, but the effective rate is what matters to people. Business people know how to judge the bottom line, and they make judgments accordingly, and we fall in the middle on that.

Can you just say very quickly whether the committee should in its thinking here be looking at the top statutory rate or is it the effective rate that is more important?

Mr. BARTHOLD. Senator Kerry, as an economist, I think it is the effective marginal tax rate on investments that is really a key factor in terms of both growth and economic efficiency allocation across sectors. Now, that said, the effective marginal tax rate depends on the statutory rate. It also depends upon cost recovery, so it depends on how this is structured.

Senator KERRY. The key would really be the interplay with whatever the expenditures and incentives and other pieces are, that is the important piece?

Mr. BARTHOLD. Yes.

Senator KERRY. But we have to always keep that in mind, not just be frozen on the rate, but look at the overall complexity of what we create underneath it.

Mr. BARTHOLD. You want to look at the overall structure of how you are taxing the income.

Senator KERRY. Now let me jump to that for a minute. I have been concerned for a long time about this issue of whether or not we inadvertently and in some cases maybe purposefully incent investment in other countries, that we are creating jobs in other countries because of the structure of the Tax Code, and the Fiscal Reform Commission recommended that we move to a territorial system and replace the current practice of taxing active foreign source income when it is repatriated, and this is obviously a current struggle. It is potentially a source of income as well as a better Tax Code and maybe a more competitive one.

Could you share with the committee whether we can strike the right balance and have a system that is globally competitive, but encourages job creation and investment in the United States even as we were to create a territorial structure? Is that doable?

Mr. BARTHOLD. Well, strike the right balance is a difficult assessment for me, Senator. That would—that is——

Senator KERRY. Well, can you envision a tax structure that does do that?

Mr. BARTHOLD. Let me, to be responsive to your question, highlight a few issues, some of which we have already talked about. Investment in the United States, things that are important to investment in the United States can be the effective marginal tax rate on the income earned by those investments, so the statutory rate, cost recovery matter. Research in the United States, many countries provide research incentives. We provide research incentives, so sort of weighing the relative, again the return to what is the return to income earned from research undertaken in the United States as opposed to research undertaken abroad would be a factor.

When we look at territorial systems, we have to think about, well, what does it say about location of any—some investments in the United States as opposed to abroad. One feature of a territorial system which I will take generically as a dividend exemption system so that income earned abroad would only be taxed at whatever rate the foreign country has brought. If we lower our domestic rate and all other countries leave their rates the same, then under a territorial system the U.S. is relatively more attractive than it was before.

Senator KERRY. But some of those countries—if I could just interrupt you for a minute, isn't it a fact that none of our major U.S. trading partners have a complete exemption with all taxes?

Mr. BARTHOLD. It is typically—there are some that are 95 percent exemption, let's call it substantially complete.

Senator KERRY. Is there a particular country you would point to where you think the model has sort of struck that balance?

Mr. BARTHOLD. I think there is a number of interesting features with policy decisions for the members to consider from a number of different countries, so I would——

Senator KERRY. Could you perhaps share with us? I think it would be great if you and your terrific staff could present us with a sense of how to perhaps strike this balance, whether there are some provisions. What we don't want to do, what we are currently doing, everybody is talking about this massive amount of American corporate revenue sitting abroad that doesn't come home because it doesn't want to be taxed. We have had one round of sort of a grace amnesty, so to speak. It didn't work so well. And the question is whether or not we can find a way to see that money more effectively, the capital formation component put to better use, and still not wind up encouraging a company to go abroad to create the jobs. I mean, there is a balance there, it is difficult.

Mr. BARTHOLD. It is definitely a policy balancing act, sir. I am happy to try and work through options with the members of the committee if that is the direction you want to go. It is complex because——

Senator KERRY. It is complex, but you have to acknowledge that what we are living with today is not effective or efficient.

Mr. BARTHOLD. What we have today is also complex and certainly has some incentives that people find creating inefficiencies.

Senator KERRY. Thank you.

Chairman HENSARLING. The co-chair now recognizes Senator Toomey of Pennsylvania.

Senator TOOMEY. Thanks, Mr. Chairman. I am glad to be following Senator Kerry, and I want to underscore my agreement with him and Senator Portman on how important it is that we really make every effort to do something substantial on the tax reform side. This is the most pro-growth thing we can do is to fundamentally reform our Tax Code. It is a way to generate very substantial revenue while lowering marginal tax rates. That creates jobs, that helps reduce our deficit problem. It can enhance fairness, which we desperately need to do.

So I appreciate your testimony. I am glad we are focusing on this.

I wanted to follow up a little bit on the vein that Senator Kerry was just discussing. You know, tax expenditures justifiably get a bad name because so many of them are, in my view, egregious flaws in the code, especially those that are narrowly targeted and have a distorting impact. But not all tax expenditures, not everything that we described as tax expenditures meets that description.

The first one on the list here on Table 5 is the deferral of active income, right?

Mr. BARTHOLD. Correct.

Senator TOOMEY. This reflects, of course, the fact that we choose not to tax at the time that it is earned income that is earned by overseas subsidiaries. If you looked at this as number one on the list and the biggest number by far on the list, you could superficially at a quick glance suggest, well, maybe this is a good source of revenue. But, in fact, I would argue that our current system puts us at a competitive disadvantage because despite whatever number there is on this form, we tax foreign income when it is brought home to a much larger degree than most of our competitors; isn't that true?

Mr. BARTHOLD. That is correct, sir.

Senator TOOMEY. So if we were to actually tax it at the time that it is earned, we would be taking the competitive disadvantage we have now and making it worse, right?

Mr. BARTHOLD. You would be creating a higher tax rate on the total income of the U.S. corporation.

Senator TOOMEY. Well, exactly, and we would be increasing the disparity, the difference between that tax rate that we charge on overseas income and that which our competitors charge?

Mr. BARTHOLD. To the extent that the competitor is in lower tax locations.

Senator TOOMEY. Which most are?

Mr. BARTHOLD. Yes, sir.

Senator TOOMEY. So one of the things that—well, I just think we should be very conscious of the fact that reducing tax expenditures, it matters very much which ones and how we were to go about doing it. I am in favor of moving in the direction of a territorial system, and I think of a lot of Pennsylvania companies, whether it is U.S. Steel or Heinz or Air Products and Chemicals, companies that have substantial operations overseas, they exist to serve local markets overseas, and what I would hate to see us do is a move in the direction that creates an even greater incentive than there already is to have corporate headquarters somewhere else because that costs us jobs, it costs us a lot of good jobs. So my preference would be that we move in the direction of a more territorial system.

I would like to get back to another line of questioning that Senator Portman raised, and that is how your methodology quantifies the feedback of variations in policy. So as I understood you, you acknowledge that personal incentives affect behavior, and so you used an example of a reduction in the payroll tax might create an incentive for someone to enter the workforce because their after-tax earnings would be that much higher. Of course that is true of any reduction in marginal income tax rates, payroll or ordinary income.

Mr. BARTHOLD. That is correct, sir.

Senator TOOMEY. And so my question is, when you analyze something like that, do you actually attempt to quantify the number of people who would enter the workforce in response to that greater incentive to work?

Mr. BARTHOLD. When we undertake our macroeconomic analysis, we report employment effects. Now, the employment effects are usually in terms of hours of work, which you can then loosely translate into, you know, numbers of individuals, but hours can also be overtime by currently employed individuals.

Senator TOOMEY. Okay. So you acknowledge that. Do you also, then, in your calculation attribute a new source of revenue from these new workers, the fact that they are paying payroll tax, at a somewhat lower rate perhaps, but they are paying tax and they didn't before?

Mr. BARTHOLD. This goes to a point we have broached a couple of times. Our macroeconomic analysis that we have been undertaking for about a decade is geared at providing supplemental information to the Members of Congress relating to tax policy changes that they are considering, and so what we routinely report are changes in gross domestic product, changes in employment, changes in investment, and we also report what this would, could mean in terms of feedback effects on revenues because general, a general premise is if national income grows, the tax base will grow, and so there will be more income subject to tax.

So in very loose terms, the answer to your question is yes. This is not reported for budget scorekeeping purposes or for House or Senate rule scorekeeping purposes, points of order, and the like.

Senator TOOMEY. Okay. I see I am running out of time. I just want to underscore, I think this is a problem with the scorekeeping methodology. I mean, your analysis, you acknowledge that a reduction in a marginal income tax rate does not have a linear impact in reducing revenue because of the positive feedback effect that offsets at least some of that, but yet we don't capture that, we don't quantify that, as I understand you to describe your process of scoring a given change in tax policy.

Mr. BARTHOLD. The macroeconomic analysis we do is not part of scoring for Congressional scorekeeping and rule purposes.

Senator TOOMEY. Thank you, Mr. Chairman.

Chairman HENSARLING. The co-chair now recognizes Congressman Van Hollen of Maryland.

Representative VAN HOLLEN. Thank you, Mr. Chairman. Thank you, Mr. Barthold, for your testimony. I just want to briefly turn to the question of pass-through entities because a lot of people have described these pass-through entities as if they were all small businesses, and I would just like to read from your testimony before the Senate Finance Committee July 14, 2010, where you say "the staff of the Joint Committee on Taxation estimates that in 2011 just under 750,000 taxpayers with net positive business income, 3 percent of all taxpayers with net positive business income, would have marginal rates that fell above $250,000;" is that correct?

Mr. BARTHOLD. If you are reading from something I said.

Representative VAN HOLLEN. I just want to make sure that fact remains true. And you have this very important caveat right here in your testimony then. "These figures for net positive business income do not imply that all the income is from entities that might be considered 'small,' in quotations. For example, in 2005, 12,862 S corporations and 6,658 partnerships had receipts of more than $50 million."

Now, my point here is not—isn't that these aren't good businesses. We should get over this conversation that all of these are small mom and pop entities because they are just not. If you had a Washington law firm with 500 partners, and those partners each took a draw of a million dollars, under this analysis they would be included as 500 distinct business entities, correct?

Mr. BARTHOLD. They would be——

Representative VAN HOLLEN. They would be included in your figure of 750,000?

Mr. BARTHOLD. How did you structure your law firm?

Representative VAN HOLLEN. As a partnership.

Mr. BARTHOLD. The partnership, we did a number of counts, and actually just to refer you to some more recent work that we have done, appendix tables in the prepared testimony that you have before you today, 10, 11, and 12, show you some ways that you can distribute partnerships and S corporations by size, either by the——

Representative VAN HOLLEN. I was just going to ask you that, Mr. Barthold.

Mr. BARTHOLD. Well, that is why I——

Representative VAN HOLLEN. Just so members realize as we have this conversation, on page 54, if you look at your charts, you will see that the top 2.2 percent of S corporations with gross receipts of more than $10 million received 61.7 percent of all the gross receipts of S corporations. Very small group. And if you look at the top 0.8 percent of partnerships with gross receipts of more than $10 million, they received 83.4 percent of all gross receipts, all gross receipts. 83.4 came from the top 0.8 percent of the partnerships. So we should remember when we are talking about this issue that we are talking about in many cases individual partners at big law firms and big lobbyist firms and considering each one of them some kind of small business generator. I just don't think—I think people need to take that into account.

Now, I want to ask you about the modeling.

Mr. BARTHOLD. Mr. Van Hollen, the only thing I wanted——

Representative VAN HOLLEN. Mr. Barthold, let me just—I am sorry, I have got 2 minutes. I want to ask you about the modeling here because Dr. Elmendorf testified before our committee, and he said that if we are to keep in place the tax cuts that were implemented in 2001, 2003 rather than allow them to lapse in our current law, we would have much larger deficits in the outyears, cumulatively 4.5 percent deficits.

Now, as I understand your testimony, higher deficits, especially during a period of time of full employment, which we all hope to get back to, that those higher deficits can have a drag on the economy; is that correct?

Mr. BARTHOLD. The higher deficit requires higher government financing, and so potentially long run crowding out of private investment.

Representative VAN HOLLEN. And that crowding out is especially true when you have full employment, correct?

Mr. BARTHOLD. Well, it is not good anytime.

Representative VAN HOLLEN. That is right. So now to get back to your scoring, though, when tax cuts are scored, whether they were 2001, 2003, because you do not take into account some of those macroeconomic effects, you also don't take into account the fact that those tax cuts could contribute to larger deficits in the outyears and slow down the economy in terms of GDP, right?

Mr. BARTHOLD. Our macroeconomic analysis, when we provide it to the Ways and Means Committee, as you know, sir, accounts for what is happening with the deficit, how the package is funded, and so it does reflect potential crowding out, if that would occur.

Representative VAN HOLLEN. Right. But I guess it does not take the next step, which would be analogous to some of the points that are being raised, which is that that crowding out leads to lower GDP, which then leads to lower——

Mr. BARTHOLD. Our macroeconomic analysis will show that.

Representative VAN HOLLEN. Right, but will it show the feedback, then, the feedback loop in terms of growth, in terms of your scoring? I am talking about your scoring.

Mr. BARTHOLD. On scoring, again, to emphasize the point just made to Senator Toomey, we use our conventional, as does the Congressional Budget Office, we use our conventional models, which are scored against the Congressional Budget Office macroeconomic baseline where we are not assuming that GNP aggregate investment, aggregate employment, inflation rate, none of those factors.

Representative VAN HOLLEN. Thanks. I hear you. So you don't take that into account, the low growth rate?

Mr. BARTHOLD. Or conventional.

Representative VAN HOLLEN. On CBO, when they score investments, when CBO looks at the investment side, investment infrastructure and education, they don't take into account either the positive economic growth benefits of that in terms of receipts, do they?

Mr. BARTHOLD. In their conventional estimates, they do not account for positive effects or the potential crowding out, depending on——

Representative VAN HOLLEN. Right. It is analogous on the CBO side in terms of investment to what you do on the tax side, correct?

Mr. BARTHOLD. Correct, sir.

Representative VAN HOLLEN. Thank you. Thank you, Mr. Chairman.

Chairman HENSARLING. That completes the first round of questioning for the first panel. We will go to the second round of questioning. The co-chair will yield to himself.

Dr. Barthold, in my opening statement I quoted from a letter from former CBO Director Dr. Peter Orszag that I believe under a current policy baseline, if solved on the tax side, that the tax rate for the lowest tax bracket would go from 10 to 25, the 25 to 63, the 35 percent bracket to 88, the top corporate income tax rate would also increase from 35 to 88 percent. Has the Joint Committee on Taxation performed any analysis that is similar to Dr. Orszag's analysis or would you have an opinion on his opinion?

Mr. BARTHOLD. I can very clearly say no because I am actually not even sure what he did and what you quoted, so I know we haven't done anything quite analogous to that. I would be happy to have my staff colleagues—I mean, we can take a look if you would like.

Chairman HENSARLING. Perhaps at a later time. I would appreciate that.

Let me go to another subject matter, and that is who actually ends up paying our corporate tax rate in America? I suppose as a practical matter many view corporations as tax collectors and not taxpayers, so clearly there is some impact on consumers perhaps in the form of higher prices, depending upon the elasticity of demand for the product or service, workers in lower wages, and then certainly to shareholders in the form of potentially lower stock prices.

Now, the last data that has come across my desk is a Congressional Budget Office analysis of about 4 or 5 years ago entitled International Burdens of the Corporate Income Tax that seemed to indicate in their analysis that 70 percent of the burden of the corporate income tax falls on labor in the form of lower wages. I don't necessarily believe you would be familiar with that particular study, but has JCT undertaken a similar study? Do you have opinions? Have you reviewed the academic literature on the subject? Do you have an opinion?

Mr. BARTHOLD. I mean, you are discussing really one of the big long-time important questions in economics, and that is what is the incidence of any tax or in particular the incidence of the corporate tax. In some of the economic literature there has been some ebb and flow in terms of its view. It is often—it had long been thought that perhaps substantially all the burden of the corporate tax fell not just on corporate shareholders because at its sort of simplest terms the corporate income tax is a tax on the income earned by the equity owners of the firm, but more generally that it would have an effect on the overall, on all owners of capital, but some of the more recent empirical work and theoretical work, some of which you just cited, has looked at the increased cross-border mobility of capital and even fixed capital, relocation of factories from one country to another country to suggest that there is a greater responsiveness to after-tax returns of capital than perhaps after-tax returns of labor, and by that they have attempted to measure and come up with results such as you have noted that perhaps a substantial amount of the burden of the corporate tax actually falls on labor, by, if we make capital flee the U.S., there is less capital in the U.S., it is capital that is key to generating labor productivity, and it is labor productivity that helps determine wages.

Chairman HENSARLING. Dr. Barthold, my time has expired. So at this time let me yield to my co-chair, Senator Murray of Washington.

Co-Chair MURRAY. Thank you very much. We hear that corporate tax reform or any tax reform must be revenue neutral, and as our Nation faces $14 trillion in debt, I think we need to be focused on job creation and long-term debt reduction. Your predecessor on JCT, Dr. Kleinbard, testified to the Senate Finance Committee last week, and he said, quote, we have to abandon our nostalgia for the Tax Reform Act of 1986. That tax reform effort was revenue neutral because it could afford to be, and that was also of course preceded and followed by major tax increases.

We hear today a lot of stories about profitable corporations, even major corporations that are using tax expenditures in order to reduce and in some cases eliminate their tax bill completely. This is infuriating for average taxpayers who are dutifully paying their taxes and don't benefit as much from these big loopholes, and I am not talking about failing companies here who might need a break. I am talking about large, profitable companies.

During this economic downturn Congress has provided generous incentives to encourage business activity; namely, through the Tax Code, and even before the downturn there were corporations that were very profitable but paid no share of Federal corporate income taxes.

So I want to ask you if you have an assessment of what it costs our Treasury in terms of lost revenue from profitable corporations that don't pay corporate income taxes.

Mr. BARTHOLD. Basically our tax expenditure analysis provides most of the assessment that you are asking about, but it does it on a provision-by-provision basis. You can't—because of interactions between them, you can't really add them up and say this is the aggregate amount lost, but the way we estimate, measure the tax expenditure is we look at what the business' tax liability would be with and without the provision in question, and so if it is a corporation that is in a loss position, there would be no tax liability regardless of the provision, so it is only looking at where there are otherwise, it would be positive taxable income. I hope that is responsive to your question.

Co-Chair MURRAY. It is a response. In my last 30 seconds I just wanted to ask you about this repatriation issue because we are hearing a lot about that. Some people say it will raise revenue, some people claim it loses revenue. What is your take?

Mr. BARTHOLD. We have undertaken some estimates of a particular proposal or a couple of different proposals, and our assessment is that if we repeated the Section 965 repatriation holiday that was enacted in 2004, that under the current baseline that that would lose revenue. There would be short-run revenue increases but long-term revenue losses, generally from longer term erosion in the corporate tax base.

Co-Chair MURRAY. Okay, thank you very much. Appreciate it.

Chairman HENSARLING. The co-chair recognizes Senator Kyl of Arizona.

Senator KYL. Thank you, Mr. Chairman. Let me just ask one follow-up question to the other questions I was going to ask in the interest of time here. You have heard a lot of frustration up here about the fact that while you can provide estimates to us of some of the behavioral impacts, that they are not reflected in the official estimates that you provide to us.

My question is how we could change that or how we could better take advantage of the behavioral estimates that you do provide. Would it require a statutory change or simply some kind of change within Joint Tax Committee to provide those behavioral effects, those feedbacks that you talked about as part of your official scoring estimates?

Mr. BARTHOLD. Well, just as a reminder, I mean, we do provide information to the Members now, and——

Senator KYL. Understood, but you made it clear that they are not part of the official scoring.

Mr. BARTHOLD. So, I mean the Members—the budget rules are. I am not a budget rule expert, and I am not sure if you wanted to change budget rules or have information reported in a different fashion for us. I mean, we try to provide information to Members in a form that is useful to them. So I am really not sure how to answer your question about what to do about budget rules or decisions that the Select Committee might want to tackle.

Senator KYL. Appreciate that. What would it take for us, for you to include those estimates that you talked about, the feedback effects and so on, in your official revenue tables, in your official scores of tax changes?

Mr. BARTHOLD. Well, as I said, for the Ways and Means Committee now on a reported bill, we do provide the macroeconomic analysis with sensitivity. So it is available for Members of Congress to read the conventional estimate and the macroeconomic analysis and then make their decisions based upon that. So as a mechanical, just as a mechanical feature, there is really nothing. I will——

Senator KYL. Well, but there——

Representative BARTHOLD [continuing]. Note there are certain time constraints.

Senator KYL. If I could just interrupt, I understand—you understand our problem——

Mr. BARTHOLD. Right.

Senator KYL [continuing]. Which is that people are going to look at the score, how much of a 10-year savings have we achieved, did we meet our goal of 1.5, and if we can't score—you and CBO are the arbiters here in some sense of the success of our policies in terms of everybody being willing to agree that it had that effect. The estimates that you give us are very useful to us, but it is not going to count in the score if there isn't a way to include it. So I am just asking, is it a matter of policy or practice? Is it something that CBO has as a policy that we would need to change? Is there a statutory change that we would have to make to include this? And if you don't know and would need to think about it, then could we visit with you some more so that we could help figure it out?

Mr. BARTHOLD. Certainly help. I might suggest that Mr. Van Hollen, who is on the House Budget Committee, might—would probably know more about this than——

Senator KYL. We will put the burden on him to answer the question then.

Mr. BARTHOLD. I am not trying to shrug the responsibility.

Senator KYL. You don't have to know the answer, but we need——

Mr. BARTHOLD. I am not a budget law expert. I mean, I think the question that you are posing, Senator, is one about House and Senate rules and about the budget law. The macroeconomic analysis that we provide currently is under a requirement under House rules. The complexity analysis that we provide with any bill was a result of legislative action, statutory action that Senator Portman was one of the primary movers on back in the late 1990s. So some of the things that we report to Members are a result of statute, some are as a result of rule.

Senator KYL. We can answer that question. I appreciate your response. Thank you very much.

Thanks, Mr. Chairman.

Chairman HENSARLING. The co-chair now recognizes Congressman Becerra of California.

Representative BECERRA. Mr. Barthold, I think we have entered this interesting realm of asking you to predict the weather. We know this is a large economy, and when it is intertwined with the economies of the rest of the world it becomes very difficult for you to come up with estimates of what a tweak here will do or a tweak there will do, but you do have conventions that you use to help you make decisions, and we have to rely on those. We have to rely on the Congressional Budget Office working with you to help us come up with these as good as you can estimates of what might happen. You have developed these over the years, have you not?

Mr. BARTHOLD. Yes, sir, and we try to, you know, update the modeling, the data, the thinking on a continuous basis.

Representative BECERRA. Are you using what you believe are the best models that we have to date?

Mr. BARTHOLD. We think we are doing—I mean, we think we have very good models. They are more sophisticated than they were 10 years ago, 15 years ago. We have upgraded in a number of areas.

Representative BECERRA. You could use some of the less conventional, some of the unconventional models that are out there that haven't been as road tested as the models you use. They may show in the future to be more accurate than yours, but they also may show that they will have been less accurate than the ones that you use?

Mr. BARTHOLD. We look at work by outsiders all the time to help inform ourselves.

Representative BECERRA. Let me ask you this. In 30 days can you come up with a better model than what you are using now to tell us what the impact will be of anything we do on tax policy or budgetary policy?

Mr. BARTHOLD. Well, I am sorry to say, Mr. Becerra, but in a 30-day time period you are probably stuck with us as we are.

Representative BECERRA. Okay.

Mr. BARTHOLD. I mean, and as you had noted, yesterday I tried to outline some of the breadth and I believe sophistication of our modeling.

Representative BECERRA. And what you do will inform us as we try to move forward. We may look at what you do and say we agree completely, we may disagree, but at some point we have to make a decision what we will use as the model. And what you are saying to us is that you have given us the best model that you can, at least within the next 30 days.

Let me ask you another question. Using that model, we have heard discussion about corporate tax reform. There is talk about eliminating those tax breaks that certain companies get over other companies and then using the money to plow back into the system to help reduce the rates for all the companies. That way you broaden the base, and you make it a fair Tax Code for all companies. If you were to eliminate all the tax breaks that right now corporations take advantage of and put the money into lower rates, using the model we have, does that help us, the 12 of us, reduce the deficits that we currently see?

Mr. BARTHOLD. Lowering—if you did something to——

Representative BECERRA. You plow back all the money that you get from removing all the tax breaks into just lowering rates, using the current model that you use, do we reduce the deficits?

Mr. BARTHOLD. Let me make an important point, and I hope I don't—I guess I will probably exhaust your time, for which I apologize.

As we have noted a couple of times, one of the large corporate overall business tax expenditures is accelerated depreciation. As I have noted, cost recovery is important in terms of determining the effective marginal rate or the user cost of capital. So it is not just looking at the statutory rate. It is also what is the statutory rate and over—and how do you get to recover costs for invested capital that determine the profitability of investments and so the decision to invest.

So if you scale back accelerated cost recovery and use the benefits of that to reduce the corporate rate, you are, on one hand, saying you are making investment less attractive by scaling back the capital cost recovery and, on the other hand, saying you are making it more attractive by reducing the marginal rate on the income when it is ultimately taxed. And that in itself is not automatically pro growth, because you are going in one direction with cost recovery and the other direction with rate.

We have—can I have a—I am sorry, sir.

Chairman HENSARLING. The witness can finish, please.

Mr. BARTHOLD. We have done some preliminary work. A couple of my colleagues presented some of this work just this last spring at a symposium at a national tax association. And it suggested within our corporate model that getting rid of accelerated depreciation and plowing just that money back into corporate tax rate is probably not going to be pro growth. It is going to be much more neutral.

Chairman HENSARLING. The time of the gentleman has expired.

The co-chair wishes to announce to members that a vote for House Members is expected at 1:30. Doing a rough calculation and in consultation with my co-chairman, I would like to ask unanimous consent that for the second panel that the first round of questioning be limited to 5 minutes and the second round of questioning be limited to 1 minute. In a rough calculation, it means that all members would be able to ask their questions.

Without objection, so ordered.

Members are also encouraged, if they so choose, to consolidate questions they may have on both panels at this time in the interest of time.

The chair now recognizes Congressman Upton of Michigan.

Representative UPTON. Thank you, Mr. Chairman.

I just want to say I am one of those folks not only on this panel but I think in the entire Congress that wants to simplify the tax code, that knows that we need real tax reform, we want to simplify the code, we want to broaden the base, we want more people working, we want to add to economic growth. It would be great if we could do it in this panel. I don't know if we can. And if we can't, we will do a long-term plan to work with Chairman Camp to make sure that that happens.

In Michigan, we have had some really tough times. You may know that our unemployment is over 11 percent, and we have had 32 consecutive months at double-digit unemployment.

My district is right on the State line. We have a new Governor. We have a new legislature. And they began to pick up the pieces and passed some tax reform and got rid of some business taxes. The person that was most upset was the Governor of Indiana, because he had billboards in my district that said "Michigan businesses, come on down", and they did.

So as I look at what we have to do on tax reform, we know that we have to compete with other nations around the world. And to comment on one of the things. I am going to yield back to you on some of my time. In the last Congress we passed a currency manipulation bill aimed at China, H.R. 2378. And I know I saw a headline today in some of the news that some of the business groups are very concerned that if this legislation came about again it would perhaps lead to retaliation by Chinese companies against American firms.

I am wondering, if you all did a study as to what the impacts of the Chinese currency manipulation really mean as it relates to U.S. businesses that export or involve trading partners in China. Have you all done anything on that?

Mr. BARTHOLD. We work with the Congressional Budget Office on what we call indirect tax effects of nontax legislation, but I do not think that we did any work on the currency bill, sir.

Representative UPTON. Would it be possible to ask you maybe or do I have to go through Chairman Camp to get a request in on that?

Mr. BARTHOLD. No, we work for all the Members of Congress. I am not that familiar with the legislation, so I will ask a couple of my colleagues to look into it.

Representative UPTON. Okay. I yield back.

Chairman HENSARLING. The co-chair recognizes Senator Baucus of Montana.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Barthold, it has been thrown around here by several people that there is about $1 trillion worth of tax expenditures annually. Could you tell me, I assume that is just a total, that it has not been—those provisions are not all scored. Because if you were to score all those, you reach a number maybe the same as or slightly different than just adding them all up.

Mr. BARTHOLD. The tax expenditure estimates are nonbehavioral estimates, and they are taken—and they are really just a measure of, if you are claiming this particular tax benefit, given your current tax position, what is the value of that benefit to you. It is not to say that if you were to eliminate that benefit that everything else that that taxpayer is doing would remain the same and you would be able to recoup all of that money.

For example, I mean, in the business tax expenditures, just to pick on one, the low-income housing tax credit, now, some businesses that invest in these low-income housing partnerships through which they earn the tax credits they generally view that as a profitable investment. So if we were to repeal that—and part of the way it is profitable is because it is tax sheltered. Well, we asked the question, where does that money go? What else happens?

Senator BAUCUS. I know. But that does raise revenue. The repeal would raise revenue.

Mr. BARTHOLD. The repeal would raise revenue, but it would not raise revenue equal to the value that——

Senator BAUCUS. That is my question. That is the point I am making. So if you total up all the deductions, the credits—let's just take the deductions, itemized deductions, the standard deductions, what would that be, roughly?

Mr. BARTHOLD. We will have to get it for you, Senator.

Senator BAUCUS. Okay. Therefore, you can't answer the next question, which is, if we want revenue neutrality, how much would that lower rates, individual rates?

Mr. BARTHOLD. I will have to—we will have to undertake that analysis. Some members have asked. We are actually in the process of trying to do something close to that.

Senator BAUCUS. The first cut is just the itemizers or the standard deduction.

Mr. BARTHOLD. Uh-huh.

Senator BAUCUS. The next level let's add, okay, exclusions and above-the-line measures. Let's say we repeal those.

Mr. BARTHOLD. Okay.

Senator BAUCUS. And then, to some degree, you get the business income. We have got interest, expense, and was it 199 deferral and so forth. It is difficult, because some of this applies to C-corps only and some doesn't.

So if you could just—the major categories show what the revenue effect is. If Category 1, if they were all repealed in Category 1, those are the standard deduction and itemized deductions, that is one. Next is exclusions and so forth, employee health care exclusion, for example. And then the other would be other business income. And what the corresponding rate reduction would be for——

Mr. BARTHOLD. I will follow up with your staff on that for you, sir.

Senator BAUCUS. Thank you.

Chairman HENSARLING. The co-chair now recognizes the Senator from Ohio, Mr. Portman.

Senator PORTMAN. Thank you, Mr. Chair.

I think all of us are going to be really interested in that information because that goes to all the issues we talked about earlier about a more efficient Tax Code and how low can the rate get, how much can you broaden the base.

I want to go through some specific corporate tax reform ideas that have come up today and maybe some concerns that have been raised and get your quick response, if I could. Because I think we have got a good hearing today on the big picture, but we left some things unanswered.

First is the impact on so-called pass-throughs. And I know there has been a discussion about pass-throughs. It is more than 80 percent of U.S. businesses. I believe that is the latest number. It is sole proprietors and partnerships, sub-Ss and LLCs in my State.

If you lowered the corporate rate and did so by getting rid of some of the existing preferences and those preferences also applied to the pass-throughs, it would seem unfair. They would still have a relatively high rate and yet they would not get the advantage of any of the changes and preferences. How would you address that apparent inequity to be sure that our smaller businesses who are pass-throughs and organized not as C-corps do not find themselves disadvantaged by corporate reform?

Mr. BARTHOLD. Well, Senator Portman, I noted earlier that I thought that it would be technically extremely, extremely difficult to wall off the elimination of preference items to one business entity and not—that it would create a lot of behavioral questions that you might or might not want to address about are you forcing people to change their choice of their preferred business entity, would you try to prohibit people from switching entity form.

As to other options, I imagine you could think of things that you might do that could provide a new preference of some sort for the pass-through—for pass-through entities. We could explore options with you on that one.

But one of the reasons I emphasize that business income is taxed as a C-corporation and business income is also taxed on the individual return was to make exactly that point, that you want to think of business income when you look at some of the reforms that you might have in mind and not——

Senator PORTMAN. Mr. Barthold, my time is short, and I apologize.

One way to do it, it seems to me, is to look at the C-corp separately so you wouldn't apply it to individual rates. You just apply it to the——

Mr. BARTHOLD. But it is very difficult to wall that off. I mean, C-corporations participate in partnerships, for example, on research ventures with individuals and other non-C-corporations.

Senator PORTMAN. Well, this is something, if you can get back to us on that, it would be very helpful. Because I know there are a number of us who have concerns about that and have some ideas about it. But we need to follow up on that.

Second is the expiring provisions. You talked about 150 over the next couple of years. Certainly the issue of certainty and predict-ability that everyone has raised here today should enter into that. In other words, some of these expiring provisions aren't nearly as effective as they should be because companies can't rely on them. And what is that impact in terms of economic growth and again in terms of extrapolating to revenue.

On depreciated and expensing, you talked about that in response to Mr. Becerra. I think we would love to see something on the complexity of current depreciation rules and some of the inefficiencies in the current system. So it is not just accelerated depreciation we are talking about, it is the whole system. Although you indicate it reduces cost of capital for investment and capital formation. It has also got a lot of complexity involved with it, which makes it less efficient than it could be.

And then, finally, the territorial side, which we don't have time to go into, evidently, since the chair is rightly stopping me, but we would love more information on, as Senator Kerry said, other ideas there.

Chairman HENSARLING. The gentleman from South Carolina, Congressman Clyburn, is recognized.

Representative CLYBURN. Thank you, Mr. Chairman.

Mr. Chairman, in 1986, a Republican President and a Democratic Congress found common ground and came to a bipartisan agreement that is similar to the one we are trying to get to today. In that agreement, capital gains rates as well as income tax rates were the same—I think it was 28 percent—and it stayed the same for about 4 years. Can you tell us whether or not there was any significant decrease in investments in the United States during that 4-year period?

Mr. BARTHOLD. I don't know the answer to that question off the top of my head. Between 1986 and 1990, the economy generally grew at a reasonable pace.

Representative CLYBURN. That same 4-year period there was growth.

Now, since 1990, we have had subsequent reductions in the capital gains tax rate. Have we seen any significant increase that can be attributed to that—to that reduction?

Mr. BARTHOLD. Well, attributing broad macroeconomic outcomes to specific provisions is always very difficult. I mean, of course, in 1991 we did have an economic downturn. We then had strong, strong growth. We had a downturn again at the turn of the century.

Representative CLYBURN. Thank you, Mr. Chairman.

Chairman HENSARLING. The co-chairman recognizes Congressman Camp of Michigan.

Representative CAMP. Thank you, Mr. Chairman.

The administration has expressed some interest in reducing the corporate rate, although we have not seen any detailed proposals or form of proposals. But most analysis is suggesting a corporate rate somewhere in the mid 20s. And the administration has suggested raising the top rate on individuals and pass-through entities to 40 percent or more.

Figure 7 of your handout shows how many more pass-through returns than C-corp returns, and the number of pass-through returns are increasing while C-corps are declining. And figure 8 shows the aggregate net income as a percentage of GDP of pass-through entities as being a significant player in the economy. So, regardless of size, I guess my point is there is a lot of economic activity and a lot of jobs in the U.S. that are connected to pass-throughs.

My question for you is, what would be the economic consequences of taxing individuals in pass-throughs at a rate that is about 15 percentage points higher than would be a rate on C-corps if in fact we did tax return and how might that distort decisions on how businesses were organized, if you have an opinion on that.

Mr. BARTHOLD. Well, I think the economics are largely as you laid out, Mr. Camp. I mean, one additional factor to add in is, remember, C-corporation income tax is a second level of tax. Shareholders receive distributions, dividends, or capital gains. So there is corporate tax and then there is a tax at the individual level.

So the sum—if we were to reduce the corporate tax, that would make a C-corporation relatively more attractive than other business entities. We might see some change, might see some diminished growth in one form at the expense of the other.

Representative CAMP. All right. Thank you.

The other question I have is, again, since 1940, there has been a budget surplus about 11 years in the U.S., looking at your Figure 3 chart on Federal receipts as a percentage of GDP. In only one of those years, 2000, was it over 20 percent, and that was largely the result of capital gains. Now, outlays or spending in that same period since 1940 never exceeded 19.4 percent of GDP of our economy, is that correct?

Mr. BARTHOLD. That sounds right, but I did not reproduce the figure, so I assume Doug Elmendorf presented that to the Joint Select Committee.

Representative CAMP. Doesn't that suggest then if we have been able to have a budget surplus in 11 years since 1940 yet we never had spending above 19.4 percent in those years and revenues were only above, as a percentage of our economy, only once in the year 2000 above that amount, doesn't that suggest that the answer has been—to controlling deficits has been to control spending, rather than to increase revenue to unsustainable levels?

Mr. BARTHOLD. Well, I am here just to be the tax weenie, Mr. Camp. I really don't have a good answer for that.

Representative CAMP. Thank you.

Chairman HENSARLING. The chair recognizes Senator Kerry of Massachusetts.

Senator KERRY. Thank you very much.

Dr. Barthold, have you, given the nonpartisan status of the Joint Tax Committee, ever compiled a list of those, quote, incentives that are not having either the intended economic impact or that don't—you know, aren't worth the level of foregone or forgiven revenue? Do you have a list of suggestions you might make to the committee about——

Mr. BARTHOLD. Not in recent memory have we really published a hit list of the type that you are suggesting. I mean, we have—as background work for both the Ways and Means Committee and the Finance Committee when they have reviewed different provisions in the, Code we have presented--

Senator KERRY. Would it be possible for you in these next weeks, given the work, the analysis and, the various modeling that you have done, do you not have already a foundation of conclusions and evidence with respect to those things that are sort of most productive?

Mr. BARTHOLD. Probably not on as many as there are.

Senator KERRY. On some, would you give us some?

Mr. BARTHOLD. We did work on some. We can present——

Senator KERRY. It would be helpful to have your judgment on that.

For instance—let me ask you a question. Are companies able to significantly lower their effective tax rate by using offshore subsidiaries to reassign the licensing of their intellectual property?

Mr. BARTHOLD. We have done some exploratory work on that, and there are certainly cases where that appears to be the case. We can't conclude that that is generally the case of all multinational corporations, but there certainly is evidence that income is being shifted abroad to foreign jurisdictions to lower overall worldwide tax revenue.

Senator KERRY. Well, we know, for instance, there is one single famous building in the Cayman Islands which has maybe 35,000, 40,000 registered companies that are not companies at all.

Mr. BARTHOLD. You are referring to Ugland House, I believe is the name.

Senator KERRY. Yes, I am.

But, clearly, those are——

Mr. BARTHOLD. But the point that you are making is what is the availability under present law to take income that would otherwise be part of the U.S. tax base and have it be reported offshore. And that is just not—that is not as simple as the existence of Ugland House, but there is a number of factors at play.

Senator KERRY. Could you share with the committee those factors. Congressman Camp just asked you I think an important question about the pass-throughs and how they are treated and how they might be treated relative to the C-corps. Could you share with us your perception of is there one factor or what are the most critical factors that have contributed to the growth of the pass-throughs and the limited liability corporations?

Mr. BARTHOLD. Well, I think there is actually—there is not one. I think there is a number of factors.

You used to do C-corporations—all public corporations basically are C-corporations. And so if you were seeking at some point the public capital markets you organized yourself as a C-corporation.

Now, there has been a lot of financial innovation. The ability of new start-ups, be they small or be they large, to access broader pools of capital has not necessitated them to necessarily go to the public market. So that has certainly been one factor.

The 1986 Tax Reform Act repealed the general utilities doctrine which was one legal doctrine that essentially made it potentially more favorable to operate in C form.

And I will defer on a third and fourth.

Senator KERRY. Well, we will follow up with you.

Chairman HENSARLING. The chair recognizes Senator Toomey of Pennsylvania.

Senator TOOMEY. Thank you, Mr. Chairman.

Mr. Barthold, we both discussed the fact that there are some very broad items that are often described as tax expenditures, the reduction of which wouldn't necessarily, obviously, be pro growth. You know, in the case of how we would treat income that is earned overseas, you make the point of how we treat depreciation.

But there is another entire category that is just egregious, it seems to me, and that does cost us economic growth by virtue of their being there. It seems to me we have as many—maybe more than a dozen different subsidies for various kinds of green energy amounting to over $2.5 billion a year. We have ethanol tax credits that are nearly $6 billion a year. We have domestic manufacturing deductions that you can get by making a movie. We have credits for rehabilitating privately owned houses. My question for you is, don't these certainly amount to the government picking winners and losers within the economy?

Mr. BARTHOLD. Well, I think that precise point was made earlier by one of the other members of the joint committee. Winners, losers, they all reflect policy decisions made by Congress at some point.

Senator TOOMEY. Right. Okay. So let me ask it this way. Do these features distort economic activity compared to what it would otherwise be?

Mr. BARTHOLD. Certainly. And that is actually part of what the tax expenditure notion is about if you favor one sector over another sector.

Senator TOOMEY. Right. Isn't it generally likely that if we use the Tax Code to distort economic activity on balance we are going to have less economic growth than we would have if we allowed the marketplace to allocate capital instead of political people?

Mr. BARTHOLD. As a general matter abstracting from the potential for what economists call externalities, the general economic thinking is that the market outcome allocates capital most efficiently.

Senator TOOMEY. And, for instance, in a specific case when it comes to these credits as they apply to energy, if you step back and look at it, if we as a society decide we are going to use the Tax Code to drive people toward the use of less efficient sources of energy, aren't we poorer as a society on balance as a result of that?

Mr. BARTHOLD. Again, if you—up to whether there might be market externalities involved, you are saying that by favoring one sector over another you are distorting choice, which means you are not getting as much total outcome as you otherwise possibly could.

Senator TOOMEY. Well, yes.

Mr. BARTHOLD. But you have made that choice for the Congress——

Senator TOOMEY. Right. For whatever other reasons, from a purely economic consideration, if you choose to use a less efficient source of energy, you have less prosperity, therefore, less growth and fewer jobs.

Mr. BARTHOLD. That is correct, sir.

Senator TOOMEY. Thank you.

Chairman HENSARLING. The chair now recognizes Congressman Van Hollen of Maryland.

Representative VAN HOLLEN. Thank you, Mr. Chairman.

I just want to agree with Mr. Camp and really with some of the observations you made earlier, Mr. Barthold, with respect to the need to consider corporate tax in conjunction with the individual tax side, given the increasing use of pass-through entities, so that we can make sure we understand the interrelationship between those things.

Looking at the corporate side, because I think there is consensus that, at the top rate, 35 percent, as has been said, is obviously higher than a lot of our competitors, much higher. Effective rates aren't necessarily all higher. But just so that we know where we are heading here in terms of the revenue and deficit impact that we have to make up if we want to do this in a revenue neutral way, is there a rough rule of thumb as to what it would cost in terms of lost revenue for every percent, you know, reduction from, say, the 35 percent rate? I have heard a rough rule of thumb about $100 billion a year.

Mr. BARTHOLD. I will have to check that for you, Mr. Van Hollen. We did a calculation like that in the past couple of years. But the enactment of expensing, which sort of changes a lot of the business cash flow over the 10-year period over which we have measured this, changes that calculation a bit. So I will get a new calculation.

Representative VAN HOLLEN. It would be helpful for us just to sort through this. Because if we wanted to do this within, say, the corporate Tax Code we would have to look at which tax expenditures we thought we should prune or eliminate in the process.

Let me just go back—circle back to a question that has been asked of you in different ways but with respect to scoring. And you have mentioned the House rules, and I have looked at some of the analyses that you have done with respect to taking into account the GDP effects. And as I understand your analyses, one of the reasons you might be reluctant to include a set rule within the score is that they take into account so many different factors in the economy, what decisions the Fed makes, whether or not deficits—you know, the cost of the tax cut is offset. I mean, is that one reason why it is complicated—it complicates being able to have a hard and fast rule on this?

Mr. BARTHOLD. There is uncertainty. And the analysis that we provided to the Ways and Means Committee is just reflective of the uncertainty.

One of the points that you made, the uncertainty can arise from when you are dealing with changes in tax policy, changes in expenditure policy, you are dealing with what economists call fiscal policy, and there has been always the uncertainty of, well, if Congress takes one path of fiscal policy, what is the Fed's monetary policy? Do they accommodate that fully or do they partially offset that? That affects the macroeconomic outcomes.

Representative VAN HOLLEN. Thank you.

Thank you, Mr. Chairman.

Chairman HENSARLING. Dr. Barthold, before you begin your next testimony, I would inform you and other members we would anticipate that the hearing would conclude 1:30-ish, 1:45 perhaps. As a courtesy to you, the chair is certainly willing to declare a 5-minute recess.

I see you are ready to plow on. You are recognized for your second round of testimony.

Mr. BARTHOLD. Well, thank you again.

What I thought I would do, if you can turn back to just the little packet of pictures and tables, is I will try and give a very, again, a brief overview of the structure of the individual income tax, some prominent features. And then I wanted to maybe address in a little bit more detail the notion of going to our tax expenditure analysis that our staff prepares annually as the ultimate template for considering tax reform.

But, first, the basic structure of the individual income tax.

An individual computes his or her taxable income by starting from gross income. You reduce that by the sum of deductions allowable to get to adjusted gross income. Those are referred to as the above-the-line deductions. The taxpayer may then choose to either claim the standard deduction or itemized deductions, and then there is a deduction for personal exemptions depending upon the taxpayer's family size.

Then graduated rates are applied to the taxpayer's taxable income to determine a preliminary tax liability. We have at present and have had for several years special lower maximum rates on income from capital gains—realized capital gains and qualified dividend income. And then the taxpayer from the preliminary tax liability may reduce that tax liability by certain allowable tax credits.

Overlaying this, as I know all the members are aware, we have an individual alternative minimum tax, which is a separate calculation which in concept was designed to limit the overall ability to claim—and I will speak very loosely—too many deductions or too many credits.

If you turn to the first page in the second part of the pamphlet, these are just really kind of the key parameters, the beginning of the key parameters through time in terms of defining the individual income tax. We have reported here from 1975 through the current year the value of personal exemptions and the standard deduction. The reason to note these is to note that the individual income tax is a personalized income tax and that it depends upon filing status—married, single, head of household—and essentially the family size, the number of personal exemptions.

Senator PORTMAN. Would you tell us what page you are on? Are you on 71?

Mr. BARTHOLD. Senator Portman, if you go back to the special packet of figures, there was a break page that said part two. And it is because I organized the testimony as individual and business, but the co-chair said they would like to talk business first, so I put together this separate packet.

So if you go to the—if you then go to the second page that is labeled Table 2, Federal individual income tax rates for 2011, I reproduced this here just to show you the rate structure which begins with a bottom rate of 10 percent. But, remember, you don't get to that 10 percent rate until you are above the level of the sum of the standard deduction and the personal exemption. So there is effectively what is known as a zero bracket. Our top rate, as you can see, is 35 percent.

But I do want to note that, as you are well aware, effective in 2013 under present law the current rate structure of 10, 15, 25, 28, 33, and 35 becomes 15, 28, 31, 36 and 39.6.

For a little bit of history, the next page of your packet, Figure 10, reproduces for joint filers for some selected years the introductory point, the bracket point, and the value of the rate of the highest statutory marginal rate. And so what you can see is the history of the top bracket and the top rate through time since 1975.

The top rate has declined from 70 percent to 35 percent, soon to be 39.6. But the entry point at which you get to that top rate has also declined. So the top bracket in real 2010 dollars used to be at an income of—taxable income of over $800,000. Today, it is approximately $375,000.

Comparable to that on the next page is Figure 11, sort of the history of where the bottom bracket begins. And you can see through time that there has not been as much change in the bottom bracket's rate, but the entry point in real dollar terms has increased. Whereas in 1975 it was approximately $13,750, measuring in today's dollars, now you have no tax liability at all until an income as a joint filer of over $18,700.

Now, an additional feature of the last 35 years is that the Congress has enacted a number of tax credits. Some are specific to specific types of activities. In the previous discussion, some energy discussions were noted. The two most significant credits are the refundable credits, the earned income tax credit and the child tax credit.

Turning now to the next page, on Table 3 I identify under our current projections the 10 largest individual tax expenditures as part of the Internal Revenue Code today. And I wanted to note, as I did for business, that several of these items have consistently been among the top 10 tax expenditure items that we report and measure since we began this exercise in 1975. Four have made the top 10 lists in eight of the sample periods that we have taken over this period: the exclusion of employer contributions for health care and health insurance premiums, the net exclusion of pension contributions and earnings from employer pension plans, the deduction for mortgage interest on owner-occupied homes, and the deduction for nonbusiness State and local taxes. That would be sales taxes and/or State income taxes.

Now, earlier—I guess it was last December now—the National Commission on Fiscal Responsibility and Reform suggested that one approach to deficit control was to undertake a serious tax reform and to do that by looking at what is actually a long list of tax expenditures that the joint committee staff publishes annually. The appeal of that is probably made most clear in Figure 13, which is the very last page of the pamphlet—of the packet.

It just shows in a simple numerical count—this is not measuring dollars, and we have had a little bit of a methodological change. I can explain that later, if you would like. But that, basically, the number of tax expenditures has grown through time. That what have may reasonably be deemed special provisions of law that deviate from a more theoretically pure income tax, that we have added additional special provisions through time. And that is what the line graph on page 13 shows.

The National Commission suggested, let's take a clean slate, eliminate all or almost all the tax expenditures. And one thing I would like to emphasize for the committee—and this is coming from I guess persons must characterize themselves as sort of a tax technician—there is a lot of decisions that the members have to make to get to that clean-slate proposal. It is really not as easy I think as a simple read of the Commission report suggests of taking a clean slate.

First of all, it is not clear as a matter of crafting legislation what it means to eliminate a tax expenditure and take a clean slate. For example, I will take a very minor tax expenditure but a tax expenditure nonetheless.

A number of employers provide fitness and weight equipment in the workplace for their employees to use as a working place fringe benefit. Well, in tax principle that is compensation to the employee, and it is compensation that goes untaxed under the individual income tax.

And so if we were to say, well, let's wipe out that tax expenditure, how do I do that? Do I have to take a valuation of the value of the weight equipment and attribute that to the employees? You know, if someone is, you know, the classic couch potato and they wouldn't touch an exercise machine for anything so they don't go to the one at the workplace, does that person get the inclusion or not? Or do we do some second-best approach and say, well, we know that the employer incurred expenses to provide those facilities. Let's deny a deduction to the employer.

Those are—if we wanted to have a clean slate, those are a lot of important decisions both in terms of how we craft the law and in terms of what the ultimate revenue effect would be. And that is the second point that I want to make. In looking at our list of tax expenditures, the dollar value of a tax expenditure, as calculated by my staff and colleagues, is not the same as the estimated revenue effect to the Federal Treasury from elimination of that provision.

As another example, home mortgage interest deduction, it is on the top 10 list that I posited there. If we were to eliminate the home mortgage interest deduction, it doesn't mean that we automatically capture the full value of all that deduction. You will see a lot of different behavioral effects. I might decide to take some additional funds out of my savings accounts and prepay part of my mortgage, reducing future interest payments that I would be making and thus affecting the tax liability and the tax revenues increases that would result in denying me a deduction for my home mortgage interest. A new home buyer might decide to buy a smaller home and thus incur a smaller mortgage than they would under the present law baseline.

So two key points I would like to keep in mind is a lot of important decisions—because it is not obvious what it means to eliminate some tax expenditures and we can't just add up the dollars that we have—that my staff and I have reported as tax expenditure values and say we can get all that and reduce the deficit dollar by dollar by an elimination—we take into account a lot of important behavior, and how the legislation is crafted also affects that estimate.

Chairman HENSARLING. Thank you, Dr. Barthold.

Before the co-chair recognizes himself, again in anticipation of pending votes in the House, with the indulgence of our friends from the Senate, the chair would like the take the liberty of calling upon House Members first and then yielding the gavel to my co-chair, Senator Murray, to conclude the hearing.

So at this time I will yield to my——

Co-Chair MURRAY. To the co-chair, many people think that this is a partisan divide. I want to just concede that the Senate is being conciliatory in the manner of this committee in allowing that to occur.

Chairman HENSARLING. Duly noted for the record.

Dr. Barthold, I want to go back to your Figure 3, Federal receipts as a percentage of GDP. And you have graced us—and I mean that sincerely—with a number of charts that are very helpful. I did not—do you have a similar chart that just deals with Federal income tax receipts as a percentage of GDP with a historical retrospective to the post war? I did not see one.

Mr. BARTHOLD. I have it in the—not a picture, but I have the back-up data for it, I believe, in the Appendix around page 7. If it would be helpful to have it in figure form, I can get that.

Chairman HENSARLING. At some point.

Because, again, I want to return to a question I had earlier. Regardless of the ongoing debate about the wisdom of raising individual marginal rates, I am just questioning from a historical perspective just how promising of a reservoir of revenue that may prove to be. Because I have looked at other data—and, again, you don't have data right in front of me that totally correlates—but I believe somewhere in the early 1950s marginal rates were as high as 90 percent, yet income tax revenue as a percentage of GDP was roughly 10 percent. Somewhere in the late 1980s I believe the top marginal rate dropped as low as 28 percent, and income tax revenue as a percentage of GDP was somewhere in the 10½ to 11 percent range, I believe. And at least the data I have seen that shows wide disparities in the top marginal bracket yet income tax revenue as presented to GDP has been roughly 9 to 10 percent. Is that a fair reading of the data? Do you have data that is similar or contrary to that——

Mr. BARTHOLD. Page 49 of the large version of my testimony has the individual income tax and the other Federal taxes as a percentage of GDP year by year from 1950 to 2010.

And just to confirm your recollection, as you did note earlier this morning, in coming out of World War II and then at the time of the Korean War top individual marginal tax rates were 90 percent or above. The 1986 Tax Reform Act lowered the top individual tax rate to 28 percent, although there had been other legislation prior to that. It didn't drop from 90 to 28. There had been other legislation prior to that.

There were at the time, both in the 1950s and then later in the 1960s, 1970s, 1980s, a lot of other things going on, both in terms of the economy and, of course, in terms of tax policy. Part of the 1986 Reform Act broadened the base, so it lowered the rate and broadened the base. In the 1950s and 1960s, there was some tax sheltering activity. Part of the 1986 Act was to try and moderate, mitigate, tax sheltering activity with a broader base and attract people into more regular investments, as opposed to tax shelter investments.

Chairman HENSARLING. Forgive me, Dr. Barthold, but my time is running out here. I want to get in one or two more questions.

In data we have seen from the Congressional Budget Office under their alternative fiscal scenario, essentially their current policy baseline, they show revenues growing in nominal terms by $2.1 trillion over the next decade. Under a current law baseline, they show tax revenues growing by $2.6 trillion over the next decade. Do you have a similar analysis? Do you agree or disagree with their figures that, either under a current policy baseline or a current law baseline, that tax revenues are predicted to increase?

Mr. BARTHOLD. Just to reemphasize, Mr. Hensarling, we do all our work consistent with the Congressional Budget Office macroeconomic and receipts baseline. So, yes, we concur. If that is how they characterized the current policy baseline, I concur in Doug Elmendorf's projections. Those are the projections that we use.

Chairman HENSARLING. In the limited time that I have, with respect to individual income tax rates, one of my colleagues brought up the question of tax fairness, which is a very important subject. It tends to be a subjective subject. It is important for a number of reasons, I assume not the least of which is compliance.

But with respect to the facts, the latest data I have seen from the IRS I believe dates back to either 2007 or 2008 and would indicate that the top 1 percent of wage earners pay approximately 40 percent of the income taxes; the top 5 percent pay approximately 60 percent of the income taxes. Do you agree with that analysis?

Mr. BARTHOLD. I will produce separate tabs for you on that——

Chairman HENSARLING. I appreciate that.

My time has expired. And, again, the gentleman from California has perfect timing, so the co-chair will yield to the gentleman from California, Congressman Becerra.

Representative BECERRA. Thank you, Mr. Chairman.

Mr. Barthold, thanks again, and let me focus on a couple of things.

We have heard quite a bit in the last several days about the Buffett rule, that someone like Mr. Buffett, one of the wealthiest men in the world, pays at a lower rate of taxation than does his secretary. Could you tell us a little bit about the features of the Tax Code that makes something like this possible, that someone who is making so much money, not a millionaire but a billionaire, could actually have an effective tax rate that is lower than his secretary?

Mr. BARTHOLD. I assume that what Mr. Buffett is referring to is his average tax rate, which is the total amount of tax that he pays over his total amount of income, although it is possible he might be referring to his marginal tax rate. I am honestly not clear on what he is claiming.

But let's assume that his secretary is paid less than approximately $106,000 a year. So that would mean that the secretary is—each additional dollar—and I will talk marginal tax rate—is subject to the individual income tax rate and is subject to the payroll tax rate. Now, Mr. Buffett, as you posited, I don't know what salary he is paid, but his total income is not all subject to the payroll tax rate, the Social Security part of payroll.

Representative BECERRA. So any individual that has an income that exceeds $106,000, $107,000——

Mr. BARTHOLD. That exceeds the wage base is not subject to the Social Security part of the payroll tax. Their wage income is still subject to the Medicare part of the payroll tax. So that would be one factor.

Representative BECERRA. So that helps lower the rate a bit for those who are wealthier or who make over $107,000 in income.

Mr. BARTHOLD. In terms of a marginal rate.

Now, if we are looking at average tax rate it becomes a little bit more complex. Because, as I noted here, depending upon your filing status and number of dependants, the first $10,000 to $15,000 to $18,000 of income is not subject to any tax and, in some situations, you are eligible for the earned income tax credit. Those features would go into calculating an average tax rate.

Representative BECERRA. Let me see if I can concentrate you a little bit, because I know my time will expire.

Someone who has a lot of investment income, passive income, you have got dollars in stocks or bonds, does the fact that part of your income or a great portion of your income is generated through those investments, through passive income, have a great deal to do with the distortion we see in someone very wealthy, having a high income paying at a lower rate than his or her secretary?

Mr. BARTHOLD. Both the relative average and/or effective marginal rate would be affected by the composition of income. Under present law, there is a top statutory tax rate on income from capital gains of 15 percent.

Representative BECERRA. So let me make sure. So capital gains, right now, 15 percent is taxed. There is a 15 percent tax on the gain on a particular investment, capital gains investment.

Mr. BARTHOLD. If you realize an asset that has a gain so your stock appreciated in value and you sold it, the gain would be taxed at a maximum of 15 percent.

Representative BECERRA. Right. Let me see if I—okay. Because I am going to quickly run out of time.

So your stock appreciated, you sold it, you had a gain on it, a profit, you are taxed at 15 percent.

Mr. BARTHOLD. That is correct.

Representative BECERRA. The secretary gets a paycheck every 2 weeks, every month, sees the payroll deduction, pays taxes on the income, could be at the higher level of up to 28 percent. She is paying at 28 percent if she has got income that takes her to that tax rate, but the profits on that stock that was sold will only pay at the 15 percent. That could account for part of why some folks who are very wealthy have a lower rate.

Now, another question. We often hear people say, well, some Americans don't pay any taxes. What they are I think really saying is they don't pay any Federal income taxes. Because most Americans will tell you, I just went to the grocery store, and I pay taxes, the sales tax. Every time I take a look at my property tax bill and I have to make that payment, I pay taxes on the property. There are certain excise taxes. So even modest-income Americans are paying taxes of some sort, is that correct?

Mr. BARTHOLD. We have a lot of different taxes in the United States, yes, sir.

Representative BECERRA. Thank you.

I yield back my time. Thank you, Mr. Chairman.

Chairman HENSARLING. The co-chair recognizes Congressman Upton of Michigan.

Representative UPTON. Thank you, Mr. Chairman.

Again, I want to reiterate and put myself firmly in support of tax reform. Though I wasn't here for Kemp-Roth I would love to vote for Camp-Baucus at some point down the line, maybe in the next 2 months.

Let me ask a couple of questions. One, you talked a little bit about the mortgage interest deduction and the fact that it may not be scored—if that was removed, it may not be scored at the $484 billion, as you have reflected here on Table 3. Have you actually—has Joint Tax actually done an analysis on if that was removed what the impact would be, the jobs and economic impact on home builders and roofers and the whole impact on the construction sector across the country if that was taken away?

Mr. BARTHOLD. We have not been asked to do that, sir.

Some of our macroeconomic capability in the modeling we do separately model a housing sector, but we have not looked at a proposal that targets a large swath of mortgage interest deductions either for new loans or existing loans.

Representative UPTON. I think that would be very important for the committee to understand in terms of the economic impact if that was removed.

The second thing, I want to get back briefly to this cap or if the 15 percent on capital gains was increased. Again, you mentioned earlier my question—there is a question as to how many folks, if you raised that percentage, would it be—would folks not bank as much or save as much? Would they spend it? What is the impact on jobs if that 15 percent capital gains tax was raised in terms of the spending power that folks will have taken away because they won't have that income for themselves? Have you done any studies on that at all or not, particularly maybe as reflected when we added a higher tax rate in earlier years?

Mr. BARTHOLD. Well, Congressman, under present law, that 15 percent rate moves to 20 percent in 2013.

And, again, we have not recently had any—really any request to analyze a broader change to raise that rate, so we have not undertaken a macroeconomic analysis. I don't even think we have done one of our conventional estimates recently for a change in that rate.

Representative UPTON. The last question that I have is, I know earlier this year former Assistant Treasury Secretary Pam Olson told the Senate Finance Committee that if the AMT survived tax reform that the committee should go back and start over. I would like to think that we would have the same view among the 12 of us here.

What are the compliance and complexity issues involved as it relates to removing the AMT? I know, as I understand it, when it first was put into place the view was that it was going to impact about 16 American families, and today obviously it is tens of thousands. So what advice do you have as it relates to that?

Mr. BARTHOLD. Well, the AMT was redesigned in 1986. And really kind of the intent of Congress in 1986, it wasn't per se a small number of higher-income families. It was really to say we are broadening the base, and we wanted to put some overall cap on the ability of people to take the deductions or special credits or exclusions that remain. Now, that in and of itself didn't automatically target it at any particular income level. The targeting was by the exemption.

Complexity, the fact that you run a dual tax system and that you plan or you have to prepare your taxes under one schedule and then go recompute under a different schedule, obviously additional time taken, additional complexity, additional chance for error.

I think everyone on our staff, of course, recognizes that a number of people are frustrated with sort of a dual system. It is a difficult policy problem that I know the members face.

Chairman HENSARLING. The co-chair now recognizes Congressman Clyburn of South Carolina.

Representative CLYBURN. Thank you, Mr. Chairman. Mr. Barthold, thank you so much. I have two quick questions.

When Dr. Elmendorf testified last week, I asked him a question about unemployment and what impact that number has on the deficit. Could you give me some idea as to whether or not you think there is any correlation between that unemployment rate, job growth, and the deficit.

Mr. BARTHOLD. Between job growth and——

Representative CLYBURN. Job growth. Let me ask it another way. The impact, reducing the unemployment. If you were to drop unemployment from 9.1 to, say, 8.6, can you give us some idea of what impact that would have on the deficit?

Mr. BARTHOLD. Well, I am sure that Doug Elmendorf probably gave a more precise estimate. I think the point that he——

Representative CLYBURN. I assure you he didn't. He said he would have to get back to us.

Mr. BARTHOLD. Oh, he did, okay. Well, then, I will wait for that, too, but I will tell you the general principle that is going to, to get lower unemployment, you are getting stronger economic growth. Stronger economic growth means that there is more national income, which means that our tax base is expanding, so if we could magically get more economic growth, you know, doing nothing, then the deficit would decline from increased economic growth, and so——

Representative CLYBURN. So there is a correlation.

Mr. BARTHOLD. I, too, will wait for Doug's analysis on that.

Representative CLYBURN. Let me ask you, what impact would lifting the payroll taxes have, if you were to lift that cap, I know it is $106,800 today, if that were moved to 212, 215?

Mr. BARTHOLD. We have not had any cause to estimate a proposal such as that. If the Joint Select Committee wanted to explore that, we could provide an estimate of that proposal.

Representative CLYBURN. Mr. Chairman, would it be okay to ask for? I would like to see some analyses——

Mr. BARTHOLD. Okay, we will provide that.

Representative CLYBURN [continuing]. Incrementally up to doubling it.

Mr. BARTHOLD. Okay. So to a wage base of $212,000 was your——

Representative CLYBURN. Maybe 150, 175, 212, some incremental steps.

Mr. BARTHOLD. Okay, a couple of different halfway marks.

Representative CLYBURN. Yes, sir.

Mr. BARTHOLD. Okay, we will respond.

Representative CLYBURN. Thank you. Finally, I also would like to see, I understand you are going to get back to us with the numbers as to who is paying how much, and I know I have been hearing talk of late about whether or not the low income pay their fair share of taxes. Could you provide us with some kind of a profile of who the taxpayers are and what kind of taxes they are paying?

Mr. BARTHOLD. Okay. We have for both Ways and Means and Finance for some hearing work have provided some analysis like that. I will assemble that and I will get that to the Joint Select Committee members.

Representative CLYBURN. I would very much like to see that. Thank you so much, and I yield back.

Chairman HENSARLING. The chair recognizes Congressman Camp of Michigan.

Representative CAMP. Thank you, Mr. Chairman. The Joint Committee on Taxation regularly publishes data on average tax rates paid by Americans, do they not?

Mr. BARTHOLD. Well, actually we don't make it a routine practice, but we end up for work for your committee and for the Finance Committee often preparing that information.

Representative CAMP. And you have recently published the data on that?

Mr. BARTHOLD. Yes, we have.

Representative CAMP. And it is made available to the public?

Mr. BARTHOLD. Yes, it is.

Representative CAMP. And you are not alone, the IRS also does this?

Mr. BARTHOLD. The IRS reports with a lag because they report on actual, compilations of actual tax returns filed.

Representative CAMP. And the Congressional Budget Office also does this, do they not?

Mr. BARTHOLD. CBO does some distribution work using slightly different modeling assumptions, but yes, they do.

Representative CAMP. And according to the recent Joint Committee on Taxation, and I just want to go at this point of millionaires and billionaires pay lower rates than middle class families, which has been out there in the public domain, and I just want to go at this point.

Mr. BARTHOLD. Certainly.

Representative CAMP. According to your recent Joint Committee on Taxation data on income, social insurance and excise taxes, Americans with incomes between $50- and $75,000 pay an average tax rate of 12.8 percent, and Americans with incomes over a million dollars pay an average tax rate of 23.6 percent?

Mr. BARTHOLD. That is income and payroll taxes combined.

Representative CAMP. Yes.

Mr. BARTHOLD. Yes, sir, that sounds——

Representative CAMP. That sounds correct? And the IRS backs this up. Every agency does a little bit different analysis, but they also have the most recent data saying on individual income tax rates Americans making a million dollars or more pay an average of 23.3 percent, so it pretty closely tracks what you say, but they say Americans between $50,000 and $100,000 pay an average rate of 8.9 percent.

Mr. BARTHOLD. Okay.

Representative CAMP. And CBO has a similar analysis. According to their most recent data on Federal taxes, and that is income, social insurance, corporate income taxes, and excise taxes, and household income, the top 1 percent of American households who earn an average, and they have a category of 1.7, above $1.7 million, pay an average tax of 31.2 percent, and middle income families pay an average—and that is between an average income of $60,700—pay 14.2 percent. So in America it is just not the case that millionaires and billionaires pay at a lower rate than middle class families.

Mr. BARTHOLD. I was going to say that is why I was trying to clarify for Mr. Becerra's question whether Mr. Buffett was talking about marginal tax rates or whether he was talking about average tax rates. What you are reporting are all what we refer to as average tax rates, taking total amount of tax paid and dividing it by your total income.

Representative CAMP. Well, frankly, Mr. Buffett needs to give his secretary a raise. But, I also want to talk about the comparisons in income of salary versus capital gains, and they are different, aren't they?

Mr. BARTHOLD. One is return to investment, the other is return to labor effort.

Representative CAMP. And in common parlance, one is taxed twice?

Mr. BARTHOLD. Capital gains from equities, from stock, the growth in the value that gives rise to the gain is in most cases from increased earnings by the business, and the business is taxed at the business level, as you noted. You can also have capital gains on other capital assets that are not in corporate form.

Representative CAMP. But for the average American in terms of the rhetorical discussion here, capital gains is taxed twice, salaries are not. Now, salaries are deductible by business entities, are they not?

Mr. BARTHOLD. That is correct.

Representative CAMP. And that is another difference; is that correct?

Mr. BARTHOLD. Well, that is your single level of tax.

Representative CAMP. Right. So the comparison of the two is not actually comparing two like commodities or two like things, which is the point I wanted to make. So I appreciate your comments, and I appreciate the work that the Joint Committee on Taxation does analyzing tax data. It does track what the IRS and the Congressional Budget Office are also saying about average tax rates paid by both middle income and high income Americans. So thank you for your testimony.

I yield back.

Mr. BARTHOLD. Thank you, Mr. Camp.

Chairman HENSARLING. Congressman Van Hollen of Maryland is now recognized.

Representative VAN HOLLEN. I thank you, Mr. Chairman. We are talking about averages of averages. In other words, average tax rates for average taxpayers over certain income levels. One of the ideas of trying to make this fair is to make sure that no individual taxpayer can take advantage of a lot of special preferences, and I would point out that the top 400 richest Americans, all making over $110 million per year and making an average of $271 million a year, paid only 18 percent of their income in income tax in 2008, the effective rate.

But what I really want to turn to is the larger conversation about tax expenditures that has been discussed by many tax experts for a long time but has gotten more popular discussion as a result of Simpson-Bowles and some of the other commissions that have looked at this. And there are a number of ways to deal with the tax expenditure issue. One is to look them over and decide to eliminate them or a subset of them. That could be used to reduce the deficit, raise revenue, and also to buy down rates.

Another way to do it is along the lines of one of the proposals the President made, which is for higher income earners, for example at the 35 percent rate you would say their deductions, regardless of what specific deduction it was, would get the 28 percent deduction level as opposed to 35 percent so that higher income individuals weren't getting, you know, a disproportionate benefit from the deduction.

A third way, and this is what I want to focus on, is to not look at any particular deduction but to find a way to limit the overall number of deductions. Then you don't have to necessarily get in a fight over whether this has important social policy or another policy. One way that has been done in the past was something named after former Congressman Pease, Don Pease, which is still an aspect of the Tax Code which sort of phases out your deductions based on your income, and one of the concerns that have been raised by some people about that, including some of our Republican colleagues, is it changes indirectly your marginal, your top marginal rates.

But there is another way to go about this, and I want to explore that, and this is in the interest of searching for common ground, and Martin Feldstein, who was of course the Chairman of the Council of Economic Advisers under President Reagan, has written about this. He has written about it in *The Wall Street Journal,* the headline of the article, "The Tax Expenditure Solution to Our National Debt;" written about it in *The Washington Post*, headline "How to Cut the Deficit Without Raising Taxes;" and I do want to just read a portion of his article.

It says, "There is a way to cut budget deficits without raising taxes. Tax expenditures are the special feature of the U.S. income tax law that subsidize a variety of things," and he says "with respect to the Simpson-Bowles proposals, their most extreme suggestion is to eliminate all tax expenditures raising a trillion dollars a year in tax revenue, and then use all but $80 billion of that to cut taxes." He goes on to comment, "I think that devotes too little money to deficit reduction at a time when fiscal deficits are dangerously large," and then he goes on to present another alternative because, as you pointed out, there may be tax expenditures that whether for policy or political reasons people aren't going to want to go after. So rather than picking one, he says "let's try and get at this overall issue," and here is his practical alternative, and I am quoting, "Congress should cap the total benefit taxpayers can receive from the combined effect of different tax expenditures. The cap could be set as a percentage of an individual's adjusted gross income and perhaps subject to an absolute dollar amount."

Mr. Barthold, my question to you is, that approach, does it address the concerns some have raised with respect to the so-called Pease approach in that the approach being presented by Martin Feldstein does not affect the top marginal rates or the marginal rates?

Mr. BARTHOLD. The short answer is yes. Do you want me to explain why?

Representative VAN HOLLEN. Yes, if you could, because again I am offering this in the spirit of common—you know, trying to find some common ground here.

Mr. BARTHOLD. By contrast, the Pease provision basically says if you earn more income, I take more of your itemized deductions away. So that has the effect, as it is drafted, of increasing your marginal rate by 3 percent. So if you were otherwise in a 31 percent bracket, your effective marginal tax rate on earning additional income, and if you are subject to the Pease provision, would be 31 percent.

Now, what Professor Feldstein has proposed is a cap that is based against—on adjusted gross income, and so as you earn more income, as your adjusted gross income goes up, the cap actually goes up, and so if the cap were binding on some taxpayers, the effect of the Feldstein proposal would be to I earn an additional $100, well, that will increase my allowable deductions by whatever the percentage cap is, so that I maybe even increase my deductions a little bit, which means my taxable income goes up by $100 or if the cap is binding, slightly less than $100. So that leaves the marginal tax rate either unchanged or in some cases will reduce it.

Now, I, too, read *The Wall Street Journal* op-ed piece by Professor Feldstein, and he had proposed a cap of 2 percent.

Representative VAN HOLLEN. Right.

Mr. BARTHOLD. Now, most of our States do have State income taxes which are deductible against the Federal income tax, and the State income taxes are generally at a rate above 2 percent, so the State income tax would generally go up and increase your itemized deductions, which means it is really sort of a wash. You wouldn't get that reduced marginal rate effect, but you would be held constant.

Representative VAN HOLLEN. At the Federal level you could actually have a reduction in your marginal tax rate?

Mr. BARTHOLD. Well, not if you are in a State with State income——

Representative VAN HOLLEN. Okay, and I would just——

Mr. BARTHOLD. It would never increase the marginal rate.

Representative VAN HOLLEN. Right.

Mr. BARTHOLD. It would only hold it constant or reduce it.

Representative VAN HOLLEN. Thank you. And I just urge my colleagues to take a look at this concept.

Chairman HENSARLING. The co-chair recognizes his co-chair, Senator Murray of Washington.

Co-Chair MURRAY. Thank you very much. I wanted to ask your opinion about this notion that tax expenditures are just another form of government spending. I have heard Chairman of the Federal Reserve, former Chairman Alan Greenspan, Martin Feldstein that was just being referred to. Both have argued that tax expenditures are simply a difference in form than in-kind as direct government spending, and I wanted to ask you, what is your assessment on whether or not tax expenditures are just simply government spending in an alternative package?

Mr. BARTHOLD. Well, Senator, that is—the construct of the tax expenditure is to say where am I doing something special, and there is a lot of different ways that government policymakers can choose to do something special. I mean, you could have a direct subsidy or you could have implicitly a subsidy through the Internal Revenue Code. So in that sense you think of tax expenditures as spending by another name.

Now that sort of begs the question of why on policy merits, you know, you decided, you know, the Congress decided to do it, why they decided to do it this way. In some cases a direct spending program could be easier to administer and more efficacious, could require fewer rules. It is possible that the opposite could also be the case, that it could be, you know, easier to administer a tax benefit than, you know, a specific new government program.

So, remember, it is a notion measured against a more, an idea of a more theoretically pure income tax and saying where I am deviating from that is I am not measuring income correctly or I am not measuring income theoretically correctly, and I am putting a value to that deviation, and so I could have said, here, measure someone's income correctly and then provide a subsidy related to whatever the activity is that you wanted to do.

Co-Chair MURRAY. Okay. Well, we have heard over and over and over again about the need to review and reduce redundant, wasteful, inefficient government spending. The Budget Control Act, which we just did, cuts a trillion dollars over the next 10 years, that is a very important step in that direction. These budget discussions and cuts are impacting directly a lot of people now as we try to put together our appropriations bills, those of us who are on that committee are watching the pain. We have reduced and eliminated programs that benefit students, we have cut support for police officers on the street, we have reduced support for programs that keep people in emergency shelters rather than homeless. I mean, these cuts are having an impact.

However, we have still largely left untouched whether it makes sense to keep a whole host of these tax expenditures, whether we should continue mortgage interest tax breaks for a yacht that qualifies as a second home, whether the entire amount of Leona

Helmsley's $8 billion charitable bequest for the care of her dogs should be left untouched, whether Kentucky thoroughbred horses should be given special tax breaks. We actually even have a tax credit for employees on former Indian lands in Oklahoma, which is now covering two-thirds of that State.

So, you know, maybe some of these tax credits make sense, maybe they don't. We have had an intense discussion here about earmarks. We have not had an intense discussion about these tax expenditures.

I wanted to ask you if you see any policy reason why we could not analyze or consider individual tax expenditures as candidates for elimination or modification outside of comprehensive reform or do we have to wait for reform of this whole system?

Mr. BARTHOLD. Senator, those sort of decisions are in your hands. I mean, the tax writing committees in their oversight role are looking at a number of these provisions all the time, so I mean, I guess I don't have an answer that is better than that for you. You certainly can explore the merits of different provisions.

Co-Chair MURRAY. Okay, thank you. I yield back my time.

Chairman HENSARLING. The co-chair now recognizes Senator Kyl of Arizona.

Senator KYL. Just a couple questions, but following up on Senator Murray's question, are tax expenditures just another form of government spending? In looking at the 10 items listed under tax expenditure in your Table 3, isn't it the fact that only one of those, the earned income tax credit, is actually scored as outlays, government outlays?

Mr. BARTHOLD. That is true.

Senator KYL. Second, relative to Representative Becerra's line of questioning, just to put a little bit of an exclamation point on this, let's say you are a teacher, you hold some stocks or you have got a pension, it has got stocks in companies, you get a dividend from that. The value of what you receive is affected by what the corporation first had to pay in its corporate taxes; isn't that correct?

Mr. BARTHOLD. That is the point.

Senator KYL. So the old saw that corporations don't pay taxes, people do is actually true, and so when—and I presume that Warren Buffet's income is largely derived from passive income of one kind or another, dividends, capital gains, whatever other kind of corporate earnings there may be on his significant investments. So to really calculate what he pays in taxes, you would also have to know what the companies that he is invested in have paid in the way of corporate income taxes, would you not?

Mr. BARTHOLD. To figure out the full burden.

Senator KYL. And that is true of anybody else with investment, with stock investments, for example?

Mr. BARTHOLD. Yes.

Senator KYL. Thank you very much.

Co-Chair MURRAY [presiding.] I will yield to Senator Portman.

Senator PORTMAN. Thank you, Madam Chair. I would like to, if I could, dig a little deeper on the individual side now that we are over there, and I would go back to the basic question, you know, what should the burden be, we have talked about that, of taxation on a weak economy, and then what is the best system.

Looking at your testimony, starting on page 35 you talk about the Simpson-Bowles approach, and you make the point that some of the revenue estimations from the Joint Committee on Taxation are going to be different than some of the general reporting from the Simpson-Bowles committee because there are some interactions between some of these tax preferences.

However, my general question for you is, have you all had the opportunity to do an analysis, to do a revenue estimate of the Simpson-Bowles proposals? I know it is a menu, in essence. If you could answer that, it would be helpful.

Mr. BARTHOLD. Well, the short answer, Senator, is no, and that is for the one reason that I elaborated on in the testimony, and that is because underlying the idea of eliminating tax expenditures is, need some policy calls on, you know, what the Members intend to do, what effective date the repeal mortgage interest deduction, would it be just for new mortgages or would it be for all?

Senator PORTMAN. I didn't provide you enough specificity to be able to come up with a score, but you could come up with a score if certain decisions were made on timing?

Mr. BARTHOLD. There is a long—if decisions were made, we would get to work, but there are a lot of decisions to be made.

Senator PORTMAN. But do you disagree with their menu? In other words, do you think that their analysis is accurate as to the various rates that you could get to based on the reduction of certain preferences?

Mr. BARTHOLD. Well, I think I have to disagree some. What they are saying is if you gave, you know, if you started with several hundred billion dollars over, let's say, you know, a 10-year period, that that would enable you to achieve, you know, X percentage point reduction in individual rates. That part of the analysis is probably, you know, reasonably consistent with the analysis that we would do.

The point that I was making was that you can't take this, my top 10 list here and add it up and say, ah, that money is available to reach that same amount of——

Senator PORTMAN. Because there will be transitions, there will be some timing issues.

Mr. BARTHOLD. Well, not just transition, but our tax expenditure calculations do not account for taxpayer behavior that would occur if you eliminated them.

Senator PORTMAN. Right, some of the interactions. Well, I think that would be very helpful, if we could give you some more specificity as to timing and specifically, you know, which preferences we are talking about because those sorts of scores are very valuable. I know you have done some of this for Senator Wyden and his good work, he did with Judd Gregg last year and with Senator Coats this year, I know you have some joint tax estimates on both the individual and corporate side there; is that correct?

Mr. BARTHOLD. Well, you know, officially we never comment on any work that we do for any individual Member, but if Senator Wyden told you that we did work for him, I am sure we did.

Senator PORTMAN. I just revealed a great secret here. My point is simply that there has been a lot of work done on the impact of some of these changes and preferences and how it would affect rates.

Mr. BARTHOLD. We have done work on a number of provisions that are like a number of things that people want to look at when they talk about modifying tax expenditures, but, again, it matters a lot what you want to do.

Senator PORTMAN. Quickly, can we talk about AMT for a second? Can you tell us what the cost is of eliminating AMT over the next 10 years under the current law baseline?

Mr. BARTHOLD. Yeah. I think we are a little bit above $1.1 or $1.2 trillion.

Senator PORTMAN. Okay, and is that with or without extension of the tax cuts? Are you talking current policy or current law? Are you talking about under the current law baseline?

Mr. BARTHOLD. That is under present law, which assumes that the current——

Senator PORTMAN. Elimination of all the Bush tax cuts?

Mr. BARTHOLD. Well, that the current—yes, that is letting EGTRRA/JGTRRA expire and also the current AMT patch would expire.

Senator PORTMAN. Which affects the AMT costs, correct?

Mr. BARTHOLD. That is correct. There is interaction——

Senator PORTMAN. What about a patch, what is a patch under the scenario of current law assuming that we are—it is about 600, 650?

Mr. BARTHOLD. I don't recall. I think it is closer to $800 billion.

Senator PORTMAN. Okay, and that again assumes—that sounds like it might assume that the top two rates do not expire or does that assume current law?

Mr. BARTHOLD. Under—I think that is under current law, yeah.

Senator PORTMAN. Okay, we would love to have those numbers. I think there is a consensus on the committee here that we want to look at least at the idea of patching the alternative minimum tax for all the reasons we talked about today.

Mr. BARTHOLD. We will provide all the members with an estimate of—when you say the patch, would you propose just indexing the current——

Senator PORTMAN. As Congress has done over the last several——

Mr. BARTHOLD. Well, Congress has done it three different ways. We will come up with something for you.

Senator PORTMAN. Okay. And in terms of AMT, have you also looked at the impact on your macroeconomic analysis we talked about earlier? In other words, if you keep the Tax Code as it is and allow the AMT to hit another 20 or 30 million Americans, what would the impact be on the macroeconomic side, including GDP?

Mr. BARTHOLD. Some of the AMT effect has been built in to past work that we have done. Since the AMT is part of present law, the way our macroeconomic analysis is undertaken is we take our conventional modeling analysis and use that to determine what the effective marginal tax rates are on different classes of taxpayers, on wage income, on their return to saving. So that is built in.

If your specific question is if we—have we done an analysis that says maintain present law except for some change in the AMT, no, we have not done such a macroeconomic analysis isolating on——

Senator PORTMAN. Okay. Thank you, Madam Chair.

Co-Chair MURRAY. Thank you. Senator Kerry.

Senator KERRY. I was reminded a little while ago, somebody mentioned the Tax Reform Act of, I guess, 1986, the rates at 70 percent, I had the pleasure of voting to get rid of the 70 percent and come down to—I think originally we chose two rates, as I recall it was 28 and 14 under the Reagan proposal.

Mr. BARTHOLD. 14 and 28.

Senator KERRY. Yes, and then we found we couldn't make it work, there wasn't sufficient revenue, et cetera, and we popped it up to the 33, and then there were sort of these incremental changes, so we have had some experience with this process.

What I would like to ask you first of all is, the tax expenditures are substantially higher today, are they not, than they were immediately after the Tax Reform Act of 1986?

Mr. BARTHOLD. Senator Kerry, tax expenditures, remember it is a measure of the value of, for example——

Senator KERRY. Well, both in total size and as a percentage of tax receipts, they are substantially higher than they were immediately after 1986?

Mr. BARTHOLD. Well, one—a nuance I want to put to that is the calculation of the tax expenditure depends upon the tax rates. Since tax rates today are higher than they were immediately after the 1986 act, absent anything else, the measure of tax expenditure——

Senator KERRY. But the tax expenditure per se hasn't been responsible for the growth? It is not the tax expenditure that has suddenly changed; it is other things, is it not? Choices we made about what to provide as a preference, perhaps?

Mr. BARTHOLD. And that is what the last figure in my short packet, you know, indicated was that Congress has made policy decisions.

Senator KERRY. Exactly, and I want to come to that for a minute because I think it is important for all of us to connect those. I think we have got to understand the relationship between those choices, that the actual tax expenditure itself post-1986 is substantially the same as the one we have today, but other things have happened. For instance, are some of the growth of tax expenditures attributable to the increase in the tax rates?

Mr. BARTHOLD. Yes, that was the point I was just making, in terms of measuring the value.

Senator KERRY. So that is one increase. Another increase, didn't we contribute to them relatively substantially when we passed the preferential treatment on capital gains and dividends?

Mr. BARTHOLD. That is one of the larger tax expenditures.

Senator KERRY. That increased that expenditure?

Mr. BARTHOLD. Yes.

Senator KERRY. Likewise, the incentive on retirement savings?

Mr. BARTHOLD. Retirement savings, as I noted here, it makes our top 10 list.

Senator KERRY. Right. And in total those are the things that have most substantially contributed to the growth of the tax expenditures, the policy choices we made?

Mr. BARTHOLD. The policy choices that Congress has made are the factor that make, that have changed the tax expenditure budget. I will note that we did include in the appendix to the submitted testimony a list of all the tax expenditure items added since the 1986 act.

Senator KERRY. Right, and that is very helpful, and I think we need to bear through it. What I want to bear down on, Dr. Barthold, is all of the major proposals—I mean, I consistently hear colleagues on both sides of the aisle, and I share this, it would be great if we could simplify, it would be great if we could create pro-growth outcome, it would be terrific if we could broaden the base and reduce the rates. I think that—are those worthy goals that we ought to be pursuing?

Mr. BARTHOLD. Improved efficiency, more growth, it all sounds pretty——

Senator KERRY. Right. Now, most of the proposals to do those kinds of things envision reducing the sort of six marginal rates, bring them down to three rates, and that is what you hear most often, and a lower rate, corporate rate, the 25 percent seems to be the one that is sort of ringing bells these days. Is it possible, in your judgment, to structure a system that lowers the rates, broadens that base, and improves progressivity and creates growth in your judgment? Can you envision that based on your experience all these years in doing this?

Mr. BARTHOLD. It is feasible. You know, as a tempering factor, you remember that it is often the case in policy-making that goals will be in conflict. Reducing tax rates sometimes is in conflict with reducing what you perceive to be the overall fairness or equity of outcomes. Improving efficiency can mean that sometimes things are made more complicated rather than less complicated. So there can be lots of trade-offs. There is lots of different policy decisions. But it is a worthy thing to try.

Senator KERRY. Is it—well, in 1986, for instance, we tried to get really super simple, we created those two rates, but then we had that tax bubble that got created as a result. Can you sort of just as a matter of helping people understand the difficulty here just talk about that for an instance, of how that bubble came about?

Mr. BARTHOLD. How the bubble came about?

Senator KERRY. Yes.

Mr. BARTHOLD. The bubble——

Senator KERRY. What I am getting at is, can we create a system where you have two or three rates and you don't create a bubble?

Mr. BARTHOLD. The bubble sort of—remember the bubble was marginal, was about marginal rates. What the bubble did was it phased out the benefit of the standard deduction and the lower rates if you were above certain income levels. So while the bubble had this range of income over which the marginal rate of tax was 33 percent and then the marginal rate of tax dropped down to 28 percent, the effect of the bubble, by eliminating essentially to such a taxpayer the benefit of a zero rate of tax, the standard deduction or the personal exemption or the 14 percent bracket, had the effect of by the time you were at the end of the bubble, your average tax rate was 28 percent, but everywhere in the bubble your average tax rate was less than 28 percent, less than 28 percent but increasing. So the bubble promoted overall progressivity but had the appearance—well, it didn't have the appearance, it had the actual effect of a marginal tax rate of 33 percent for someone in the bubble range and then the marginal tax rate dropped back down to 28 percent beyond the bubble range. But the person beyond the bubble range had a higher average tax rate than a person in the bubble or a person beneath the bubble.

Senator KERRY. So it is all very simple. We will get there.

Mr. BARTHOLD. I hope that was responsive. It was sort of a technical point.

Senator KERRY. No, it is an important point and I appreciate it. Thank you.

Co-Chair MURRAY. Senator Toomey.

Senator TOOMEY. Thanks very much, Madam Chairman. I want to go back to the topic of capital gains because I just think this is very, very important, and the one observation that I want to make is that I think it is abundantly clear that it is the investment of accumulated capital that makes economic growth possible, and any policy that diminishes that accumulated capital is very, very dangerous in terms of its implications for economic growth. Congressman Camp and Senator Kyl both observed that when capital gains are imposed on the appreciated value of a stock, it is almost certainly a form of double taxation because the underlying stock has been—had the income associated with it taxed in the first place, and that is certainly completely true.

I would like to make another point about this which has to do with inflation. Mr. Barthold, I am sure you would agree that in the post-war era our economy has had no sustained periods of deflation. We have had inflation of varying levels, but consistently. And we charge, we impose a capital gains tax on a nominal gain in value of an asset, not on the real gain. So that is to say that we impose the capital gains tax on the inflationary gain. Is that true?

Mr. BARTHOLD. Yes, it is correct. We tax nominal values throughout the Internal Revenue Code.

Senator TOOMEY. So if you had a sustained period where inflation averaged just 3 percent, as the math works out in 24 years, the value of assets doubles. I shouldn't say the value, the nominal price doubles, but yet the real value hasn't gone up at all in that scenario, and yet we would still impose a capital gains tax, wouldn't we?

Mr. BARTHOLD. That is correct.

Senator TOOMEY. So, in effect, what we are doing in the case of assets that appreciate in value, if the appreciation were due only to really the loss of value of the dollar and inflation, you would have zero real gain, and yet you would pay a tax, so you would literally be paying a tax, despite having no gain in real terms; isn't that true?

Mr. BARTHOLD. That is correct, sir.

Senator TOOMEY. So it seems to me that this phenomenon has long been part of the reason that at least we try to mitigate that by having a capital gains rate that is lower than ordinary income tax rates, just one of the rationales?

Mr. BARTHOLD. That has been one of the stated policy rationales, sir.

Senator TOOMEY. Thanks, and I will yield the balance of my time.

Co-Chair MURRAY. Thank you very much. Under our agreement we had agreed that each member would have an additional minute. But, Mr. Barthold, you have been generous with your seat time here. In the interest of being a good example, I will yield back my time.

Representative Becerra, do you have one additional question?

Representative BECERRA. I do, I will make use rapidly of my one minute.

Mr. Barthold, very interesting here because I think everyone would agree that the Tax Code is neither simple or transparent, and the reality is that complexity, the opposite of simplicity, is what helps people hide what they should pay in taxes, and so if you have complexity and at the same time you don't have transparency, which is, acts like complexity in helping you hide your income, you can get away without paying what would be your otherwise fair share.

Now, it is really fascinating the way we treat corporations because there is this concern that we tax twice income that comes from a corporation because ultimately the individual is the one that pays the taxes. Are any Americans forced to form a corporation?

Mr. BARTHOLD. No, sir. Corporate is an elective form of business.

Representative BECERRA. Right. So if it is so bad, why are so many people forming corporations? Because they get certain benefits by doing so, whether it is on the tax side or otherwise. So I think we have to recognize that complexity and transparency, whether it is on the corporate side or individual side, should be removed so we can truly understand how we get to a fair Tax Code.

I yield back.

Co-Chair MURRAY. Representative Van Hollen.

Representative VAN HOLLEN. Thank you, Madam Chairman. Just to pick up on Mr. Becerra's question, because we have heard a lot about the double taxation of capital gains, but isn't it true that there are many assets that get the preferred 15 percent capital gains rate that are not subject to another layer of taxation, real estate, commodities, S corporations; isn't that true?

Mr. BARTHOLD. Yes, I made that point briefly when Mr. Camp was discussing the issue.

Representative VAN HOLLEN. Do you have any idea, you know, how that compares in magnitude to the overlapping?

Mr. BARTHOLD. Off the top of my head, I don't. Our staff has looked at that, and I can report from—back to the committee on, from what—the IRS creates a sale of capital asset files where we get some detailed information on what sort of assets do people realize in reporting capital gains. We will run some tabulations on the SOCA file, and I will make that available to the members of the Joint Select Committee.

Representative VAN HOLLEN. Thank you, Mr. Barthold. Thank you.

Co-Chair MURRAY. Thank you very much. I want to thank the witness today for participating and all of our members who were here today as well. I remind all of our members that they have 3 business days to submit questions for the record, and I would ask the witness to try and respond as quickly as possible. So all of our members should submit their questions by the close of business on Tuesday, September 27th, and with that without objection, the joint committee stands adjourned.

[Whereupon, at 1:45 p.m., the committee was adjourned.]

APPENDIX

Additional Material Submitted for the Record

JOINT COMMITTEE ON TAXATION
September 22, 2011
JCX-49-11

TESTIMONY OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION BEFORE THE JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

SEPTEMBER 22, 2011

My name is Thomas A. Barthold. I am the Chief of Staff of the Joint Committee on Taxation. It is my pleasure this morning to provide a brief overview of the Federal tax system. You asked if I could emphasize the income taxation of individuals and corporations. My written testimony provides additional details and includes an appendix with further information. Members have separately been provided with several charts and tables to which I will refer during my oral testimony.

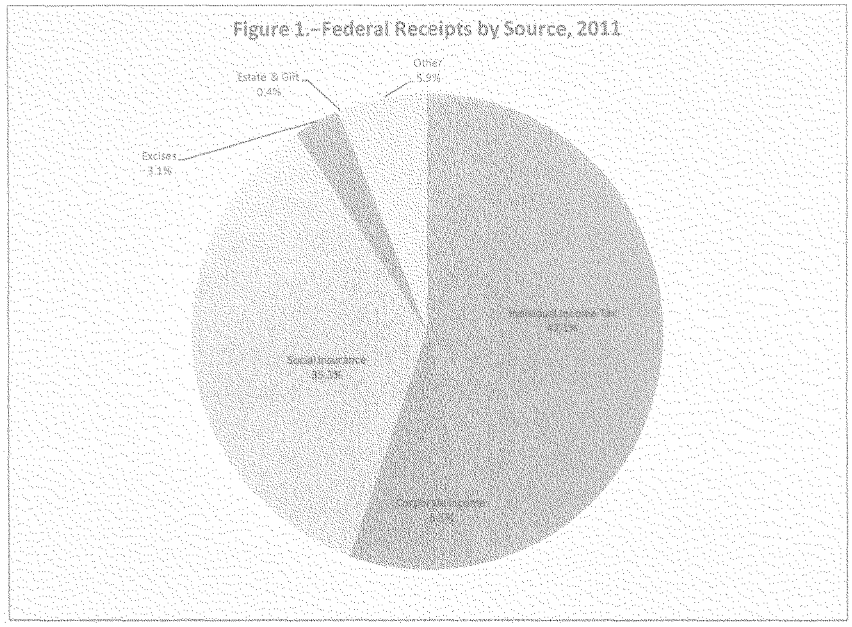
The staff of the Joint Committee on Taxation is nonpartisan and serves the entire Congress. The staff of the Joint Committee on Taxation includes experienced professional economists, attorneys, and accountants, who assist Members of the majority and minority parties in both houses of Congress on tax legislation.

I. OVERVIEW OF THE FEDERAL INCOME TAX SYSTEM

A. Historical Federal Receipts by Source

Figure 1 below shows aggregate Federal receipts by source for 2011. The individual income tax is the largest source of Federal revenue, comprising 47.1 percent of the total Federal revenues, while social insurance (employment) taxes[1] are the second largest source of revenue at just over 35.3 percent. No other single source constitutes more than ten percent of Federal revenue.

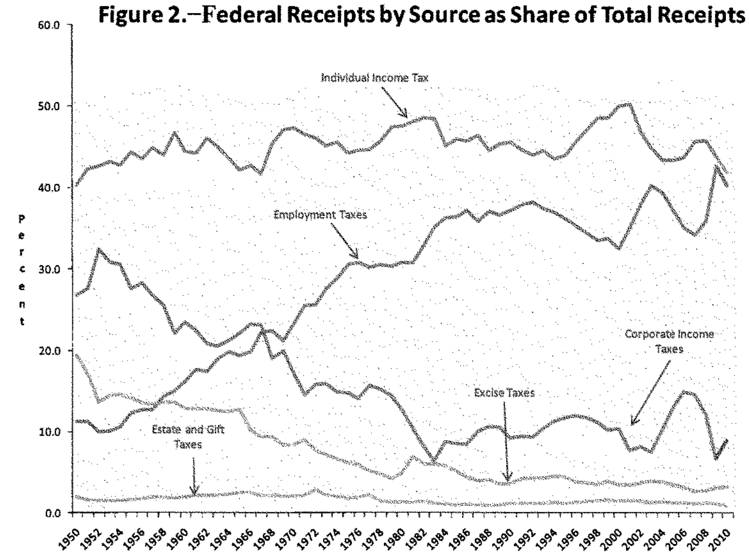
[1] The principal social insurance (employment) taxes are the Federal Insurance Contributions Act (FICA) and Self-Employment Contributions Act (SECA) taxes that fund the Social Security and Medicare systems.



Source: Congressional Budget Office, August 2011 baseline.

Figure 2 below shows Federal receipts by source as a percentage of all Federal receipts from 1950 to 2010. The individual income tax has always been the largest source of Federal revenue, oscillating around its average share of 44.8 percent over this period. The corporate and excise taxes have declined as a percentage of all revenues, and social insurance taxes have risen substantially from around 10 percent of the total in the early 1950s to levels generally varying between 35 and 40 percent in recent years.

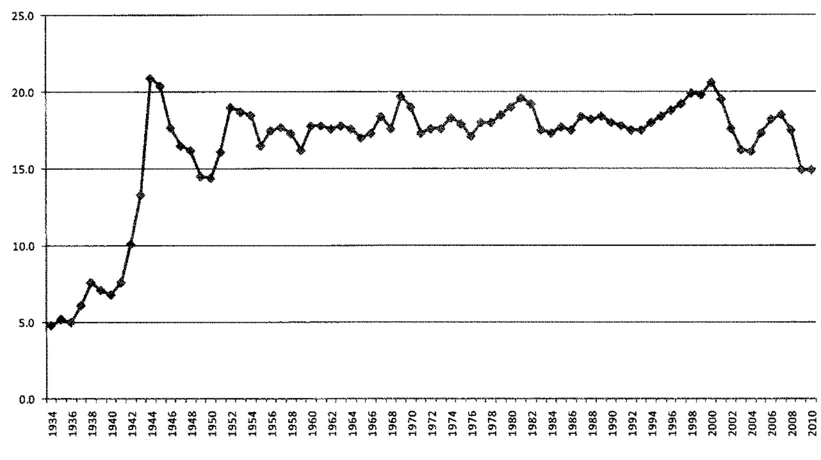
Figure 2.–Federal Receipts by Source as Share of Total Receipts



Source: Office of Management and Budget; Historical Tables, Budget of the U.S. Government, Fiscal Year 2012 and Staff of the Joint Committee on Taxation Calculations.

Figure 3 below shows receipts as a percentage of GDP from 1934 to the present. Since 1950, total Federal receipts have averaged 17.9 percent of GDP. The drop in receipts as a percent of GDP in 2009 and 2010 (to 14.9 percent) reflects the impact of both the economic recession and the legislated tax reductions of the American Recovery and Reinvestment Tax Act of 2009.[2] Receipts as a share of GDP have not been this low since 1950.

Figure 3.–Federal Receipts as a Percentage of GDP

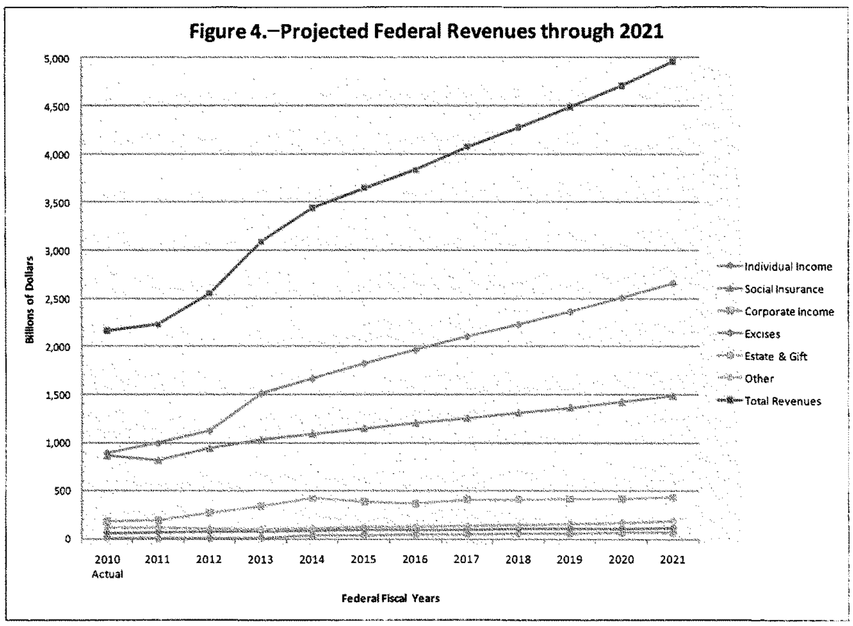


Sources: Office of Management and Budget, Historical Tables, Budget of the U.S. government, Fiscal Year 2012, Table 2.3.

[2] Pub. L. No. 111-5.

Figure 4 below shows total projected Federal revenues by source over the current budget period, through 2021.

The increase in social insurance receipts in 2012 reflects the expiration of the temporary (for 2011 only) reduction in employee social insurance taxes by 2 percentage points. The increase in individual receipts in 2013 reflects the expiration of numerous provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001,[3] the Jobs and Growth Tax Relief Reconciliation Act of 2003,[4] and the American Recovery and Reinvestment Tax Act of 2009.[5]



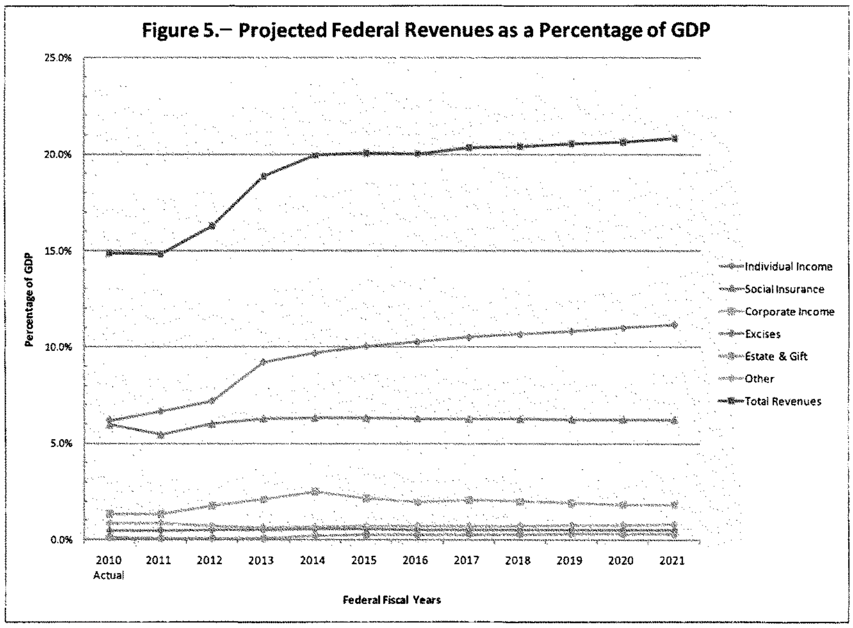
Source: Congressional Budget Office, January 2011 baseline.

[3] Pub. L. No. 107-16.

[4] Pub. L. No. 108-27.

[5] Pub. L. No. 111-5.

Figure 5 below shows the same projections as Figure 4 above as a percentage of GDP. Total revenues are projected to rise from about 15 percent of GDP currently to about 20 percent of GDP by 2014, rising gradually to about 21 percent of GDP in 2021.



Source: Congressional Budget Office, January 2011 baseline.

B. Variety of Business Organizations

The preceding figures have showed the importance of the individual income tax and corporate income tax to the Federal tax system. However, it is important to recognize that not all businesses are organized as corporations and, consequently, the taxation of active business income occurs both for taxpayers that file Form 1120 (the corporate income tax return) and for taxpayer who file Form 1040 (the primary individual income tax return).

Businesses may be organized under a number of different legal forms. Owners of a business sometimes conduct their activities as sole proprietorships, which do not involve a legal entity separate from the owner. However, for a variety of business or other reasons, a business often is conducted through a separate legal entity. Common reasons to use a separate legal entity include the ability to pool the capital and other resources of multiple owners, the protection of limited liability accorded by State law to the owners of qualifying entities (but generally not to sole proprietors), and an improved ability to access capital markets for investment capital.

The tax consequences of using a separate entity depend on the type of entity through which the business is conducted. Partnerships, certain closely held corporations that elect to be taxed under subchapter S of the Code (referred to as "S corporations"),[6] and limited liability companies that are treated as partnerships are treated for Federal income tax purposes as passthrough entities whose owners take into account the income (whether or not distributed) or loss of the entity on their own tax returns.

In contrast, the income of a C corporation[7] is taxed directly at the corporate level. Shareholders are taxed on dividend distributions of the corporation's after-tax income. Shareholders are also taxed on any gain (including gain attributable to undistributed corporate income) on the disposition of their shares of stock of the corporation. Thus, the income of a C corporation may be subject to tax at both the corporate and shareholder levels.[8]

---

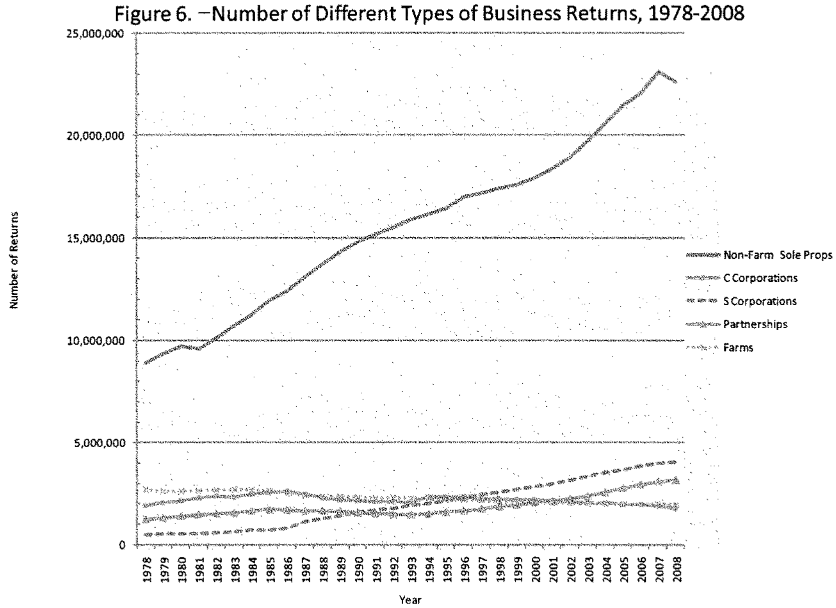
[6] To be eligible to make an election under subchapter S a corporation must generally (1) be an eligible domestic corporation; (2) not have more than 100 shareholders (taking into account applicable attribution rules); (3) have as shareholders only individuals (other than nonresident aliens), estates, certain trusts and certain tax-exempt organizations; and (4) have only one class of stock.

[7] A C corporation is a corporation that is subject to subchapter C of the Code, which provides rules for corporate and shareholder treatment of corporate distributions and adjustments. C corporations generally are subject to the corporate-level tax rate structure set forth in section 11 of the Code.

[8] Business entities also include specialized corporations which are not subject to entity level tax, or which are allowed a deduction for distributions to shareholders, under the Federal income tax rules. Federal tax rules applicable to these entities generally require that they distribute substantially all their income and require that they meet other specified limitations on activities, assets, and types of income, for example. These types of entities include regulated investment companies (RICs) (mutual funds in common parlance), real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), and cooperatives. In addition, some business activities are conducted through tax-exempt entities, whether as activities subject to unrelated business income tax (UBIT), or as permitted under the Federal tax rules relating to tax-exempt organizations.

Figure 6 below shows the change in number of different types of business returns for the period 1978 through 2008.

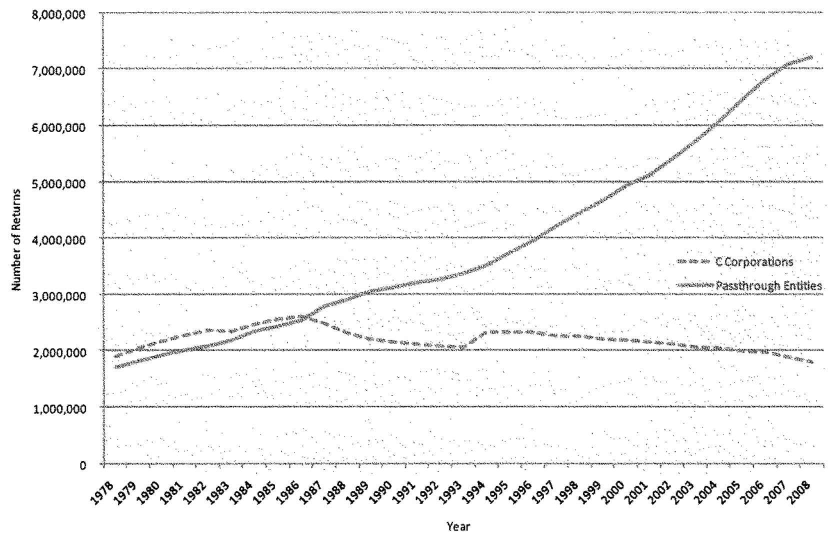
Figure 6. –Number of Different Types of Business Returns, 1978-2008



Source: Internal Revenue Service, Statistics of Income, published and unpublished data.

Figure 7 below compares the number of C corporation returns to the total number of passthrough entity returns (S corporations, partnerships and LLCs taxable as partnerships) over the same period.

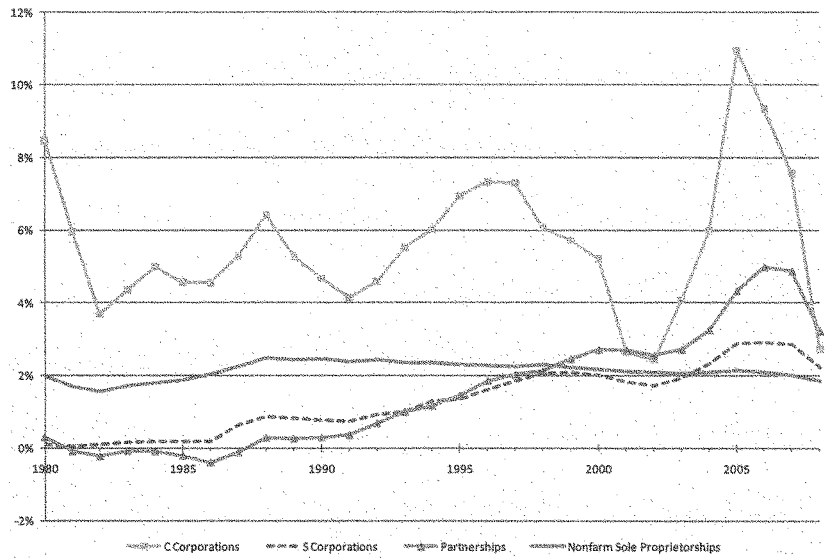
Figure 7. –Number of C Corporation Returns Compared to the Sum of S Corporation and Partnership Returns, 1978-2008



Source: Internal Revenue Service, Statistics of Income, published and unpublished data.

Figure 8 below shows the income of various business forms as a percentage of GDP over the period 1980 through 2008.

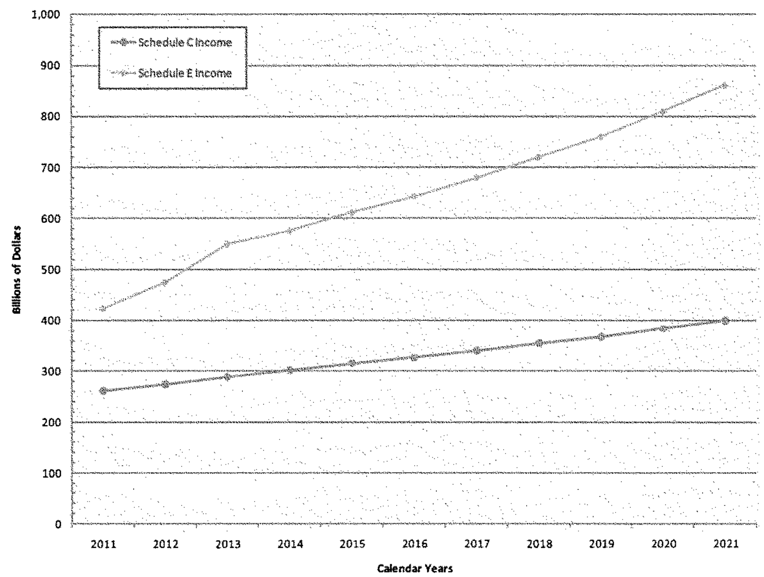
Figure 8.—Aggregate Net Income (less deficit) as a Percentage of GDP
1980 - 2008



Source: IRS Statistics on Income.

Figure 9 below shows projected business income earned by sole proprietorships, reported on Schedule C, and income reported on Schedule E, over the period 2011 - 2021. While total adjusted gross income is forecast to increase somewhat more than 70 percent over this period, passthrough income reported on individual returns (the sum of income reported on Schedules C and E) goes up by over 80 percent. Growth in this passthrough income is driven by growth in Schedule E income, which is projected to more than double.

Figure 9.—Projected Schedule C and Schedule E Income, 2011 - 2021



Source: Joint Committee on Taxation.

II. OVERVIEW OF THE INDIVIDUAL INCOME TAX

A. Structure of the Individual Income Tax

In general

An income tax is imposed on individual citizens and residents of the United States.[9] The tax is based on an individual's taxable income. An individual computes his or her taxable income by reducing gross income by the sum of (i) the deductions allowable in computing adjusted gross income, (ii) the standard deduction (or itemized deductions, at the election of the taxpayer), and (iii) the deduction for personal exemptions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her income tax liability. Lower rates apply to net capital gain and qualified dividend income. A taxpayer may also be subject to an alternative minimum tax. A taxpayer may reduce his or her income tax liability by certain tax credits. In the remainder of this section of the document, the broad structure of the individual income tax system is outlined, and certain parameters of the individual tax system are highlighted for selected years beginning with 1975.[10]

Gross income

Gross income means "income from whatever source derived" other than certain items specifically excluded from gross income. Sources of gross income generally include, among other things, compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income in respect of a decedent, and income from S corporations, partnerships,[11] and trusts or estates.[12] Exclusions from gross income include death benefits payable under a life insurance contract, interest on certain tax-exempt State and local bonds, employer-provided

---

[9] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States.

[10] For more information regarding individual tax rates and the individual tax base, see Joint Committee on Taxation, *Federal Tax Treatment of Individuals* (JCS-43-11), September 12, 2011, and Joint Committee on Taxation, *Present Law and Historical Overview of the Federal Tax System* (JCS-1-11)), January 18, 2011.

[11] In general, partnerships and S corporations are treated as passthrough entities for Federal income tax purposes. Thus, no Federal income tax is imposed at the entity level. Rather, income of these entities is passed through and taxed to the partners and shareholders, whether distributed or not.

[12] In general, estates and trusts (other than grantor trusts) pay an individual income tax on the taxable income of the estate or trust. Items of income which are distributed or required to be distributed under governing law or under the terms of the governing instrument generally are included in the income of the beneficiary and not the estate or trust. Estates and trusts determine their tax liability using a special tax rate schedule and may be subject to the alternative minimum tax. Certain trusts are treated as being owned by grantors in whole or in part for tax purposes; in such cases, the grantors are taxed on the income of the trust.

health insurance, employer-provided pension contributions, and certain other employer-provided benefits.

Adjusted gross income

An individual's adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions from gross income. These deductions include, among other things, trade or business expenses, losses from the sale or exchange of property, deductions attributable to rents and royalties, contributions to pensions and other retirement plans, certain moving expenses, and alimony payments.

Taxable income

In order to determine taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Table 1 below summarizes the amount of personal exemptions for selected years between 1975 and 2011. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. Beginning in 1985, the amount of the personal exemption was indexed annually for inflation during the preceding year.

Table 1.–Personal Exemption and Standard Deduction, Selected Calendar Years 1975-2011

	1975	1985	1990	1995	2000	2005	2011
Personal Exemption	$750	$1,040	$2,050	$2,500	$2,800	$3,200	$3,700
Standard Deduction							
Single Individual	$1,600*	$2,390	$3,250	$3,900	$4,400	$5,000	$5,800
Head of Household	$1,600*	$2,390	$4,750	$5,750	$6,450	$7,300	$8,500
Married Couples Filing Jointly	$1,900*	$3,540	$5,450	$6,550	$7,350	$10,000	$11,600
Married Individual Filing Separately	$950*	$1,770	$2,725	$3,275	$3,675	$5,000	$5,800

* Shows minimum standard deduction.

A taxpayer may also reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. Also, an additional standard deduction is allowed with respect to any individual who is elderly or blind.[13]

[13] For 2011, the additional amount is $1,150 for married taxpayers (for each spouse meeting the applicable criteria) and surviving spouses. The additional amount for single individuals and heads of households is $1,450. If an individual is both blind and aged, the individual is entitled to two additional standard deductions, for a total additional amount of $2,300 or $2,900, as applicable.

In lieu of taking the applicable standard deduction, an individual may elect to itemize deductions. The deductions that may be itemized include State and local income taxes (or, in lieu of income, sales taxes), real property and certain personal property taxes, home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5 percent of AGI), casualty and theft losses (in excess of 10 percent of AGI and in excess of $100 per loss), and certain miscellaneous expenses (in excess of two percent of AGI).

In recent decades there have been many changes to the individual income tax base. The increased availability of pre-tax contributions to Individual Retirement Arrangements[14] (commonly called "IRAs") followed by the subsequent curtailment of their availability[15] and the taxation of a portion of Social Security and Railroad Retirement Tier 1 benefits[16] are two items which affect the measurement of gross income for some taxpayers. The enactment of pre-tax elective contributions under tax-qualified employer-sponsored retirement plans and the enactment of "pre-tax elective benefits" designed to respond to increased health-care costs are examples of changes to adjusted gross income.[17] The calculation of taxable income has been affected by the numerous changes to itemized deductions. Examples of such changes include the creation of the two-percent floor on miscellaneous itemized deductions,[18] changes to the tax treatment of moving expenses,[19] and changes to the floor on the itemized deduction for medical expenses.[20] Another significant change to the individual income tax base was the enactment of a limitation on passive activity losses, which may affect an individual's tax liability on certain business investments.

Tax liability

In general

A taxpayer's net income tax liability is the greater of (1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) tentative minimum tax reduced by credits allowed against the minimum tax.

---

[14] The Economic Recovery Tax Act of 1981 (Pub. L No. 97-34).

[15] The Tax Reform Act of 1986 (Pub. L. No. 99-514).

[16] The Social Security Amendments of 1983 (Pub. L. No. 98-21), as amended by the Railroad Retirement Solvency Act of 1983 (Pub. L. No. 98-76) and the Consolidated Budget Reconciliation Act of 1985 (Pub. L. No. 99-272). The Omnibus Budget Reconciliation Act of 1993 (Pub. L. No. 103-66).

[17] The Revenue Act of 1978 (Pub. L. No. 95-600).

[18] The Tax Reform Act of 1986 (Pub. L. No. 99-514).

[19] The Omnibus Budget Reconciliation Act of 1993 (Pub. L. No. 103-66).

[20] The Internal Revenue Act of 1954 (Pub. L. No. 83-59) set the floor at three percent, the 1982 Tax and Equity Fiscal Responsibility Act (Pub. L. No. 97-248) raised the floor to 5 percent, the Tax Reform Act of 1986 (Pub. L. No. 99-514) raised the floor to 7.5 percent, and the Patient Protection and Affordable Care Act (Pub. L. No. 111-148) raised the floor to 10 percent (for taxable years beginning after December 31, 2012).

Regular tax liability

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases.

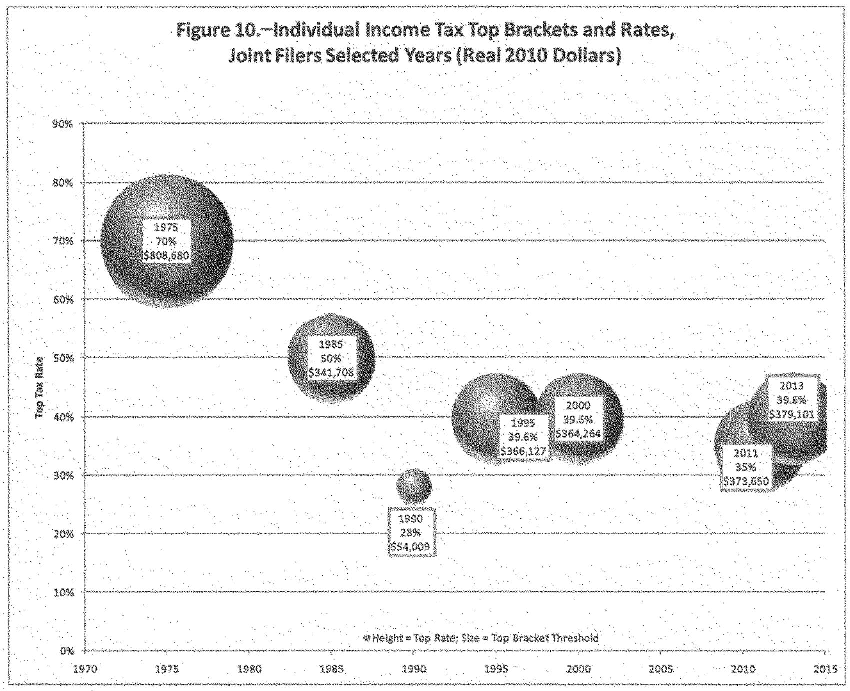
Separate rate schedules apply based on an individual's filing status. Table 2 shows the individual income tax rate schedule for 2011. It should be noted that these rates will change in 2013 when individual income tax rates will increase from the current rates of 10, 15, 25, 28, 33, and 35 percent to the rates of 15, 28, 31, 36, and 39.6 percent.

Table 2.–Federal Individual Income Tax Rates for 2011

Single Individuals	
If taxable income is:	*Then income tax equals:*
Not over $8,500	10% of the taxable income
Over $8,500 but not over $34,500	$850 plus 15% of the excess over $8,500
Over $34,500 but not over $83,600	$4,750 plus 25% of the excess over $34,500
Over $83,600 but not over $174,400	$17,025 plus 28% of the excess over $83,600
Over $174,400 but not over $379,150	$42,449 plus 33% of the excess over $174,400
Over $379,150	$110,016.50 plus 35% of the excess over $379,150
Heads of Households	
Not over $12,150	10% of the taxable income
Over $12,150 but not over $46,250	$1,215 plus 15% of the excess over $12,150
Over $46,250 but not over $119,400	$6,330 plus 25% of the excess over $46,250
Over $119,400 but not over $193,350	$24,617.50 plus 28% of the excess over $119,400
Over $193,350 but not over $379,150	$45,323.50 plus 33% of the excess over $193,350
Over $379,150	$106,637.50 plus 35% of the excess over $379,150

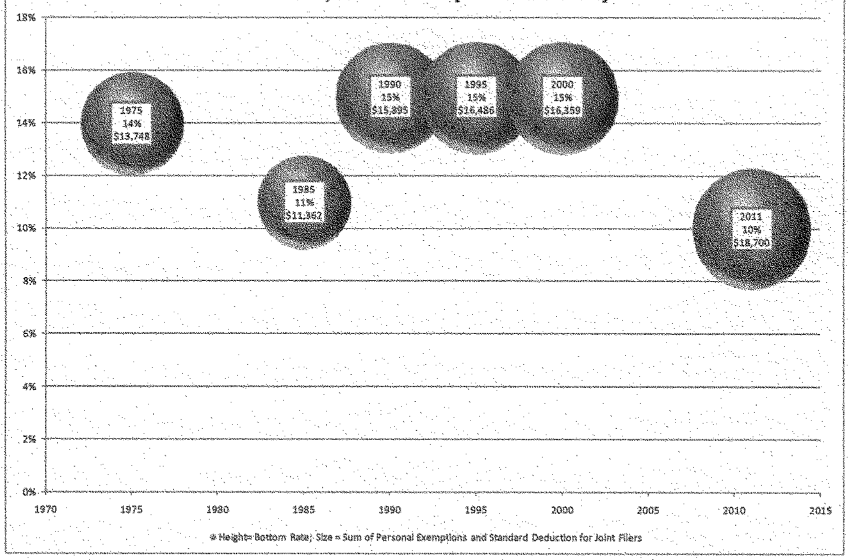
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,000	10% of the taxable income
Over $17,000 but not over $69,000	$1,700 plus 15% of the excess over $17,000
Over $69,000 but not over $139,350	$9,500 plus 25% of the excess over $69,000
Over $139,350 but not over $212,300	$27,087.50 plus 28% of the excess over $139,350
Over $212,300 but not over $379,150	$47,513.50 plus 33% of the excess over $212,300
Over $379,150	$102,574 plus 35% of the excess over $379,150
Married Individuals Filing Separate Returns	
Not over $8,500	10% of the taxable income
Over $8,500 but not over $34,500	$850 plus 15% of the excess over $8,500
Over $34,500 but not over $69,675	$4,750 plus 25% of the excess over $34,500
Over $69,675 but not over $106,150	$13,543.75 plus 28% of the excess over $69,675
Over $106,150 but not over $189,575	$23,756.75 plus 33% of the excess over $106,150
Over $189,575	$51,287 plus 35% of the excess over $189,575

Figure 10 below shows the top tax bracket rate and income level at which it begins to apply for married tax payers filing jointly for selected years. Figure 11 shows the bottom rate and the income level at which it would begin to apply for married taxpayers filing jointly, calculated as the sum of the standard deduction and two personal exemptions.



Note: For 1975 the maximum rate on earned income was 50 percent.

Figure 11.–Individual Income Tax Bottom Rates and Bracket Thresholds, Joint Filers; Selected Years [Real 2010 Dollars]



Capital gains

In general

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. However, any net capital gain of an individual generally is taxed at rates lower than rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S.

publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Tax credits

An individual may reduce his or her tax liability by any available tax credits.

Refundable tax credits

The two most widely used refundable credits are the earned income tax credit (the "EITC") and the child tax credit.

Earned income tax credit.–The EITC generally equals a specified percentage of wages up to a maximum credit amount. The maximum credit amount applies over a certain income range and then diminishes to zero over a certain income range. In 2011, the maximum EITC is $5,751 for taxpayers with more than two qualifying children, $5,112 for taxpayers with two qualifying children, $3,094 for taxpayers with one qualifying child, and $464 for taxpayers with no qualifying children.

The EITC is phased out along certain phase-out ranges. In 2011, the phase-out range is $7,590 to $13,660 for no qualifying children, $16,690 to $36,052 for one qualifying child, $16,690 to $40,964 for two qualifying children, and $16,690 to $43,998 for three or more qualifying children. Also for 2011, the phase-out threshold for married couples filing a joint return is increased by $5,080.

After 2012 the larger EITC for three or more qualifying children and the higher phase-out threshold for married couples filing a joint return are repealed. Additionally, certain of the rules of the credit return to pre-2001 law.

Progression of the EITC

Although the basic structure of the EITC is unchanged since its enactment in 1975, the maximum credit has been increased several times since enactment by expanding the applicable percentage of the credit and the base against which that percentage is applied (including adjusting the EITC for number of qualifying children). Also, the beginning point of the phase-out range has been raised as has the length of the phase-out range. Finally, the dollar amounts of the credit have been automatically adjusted for inflation. In all, these changes have had the effect of further expanding the availability of the EITC.

As originally enacted in 1975, the credit was 10 percent of the first $4,000 of earned income[21] (i.e., a maximum credit of $400). The credit began to be phased out for filing units with earned income (or AGI, if greater) above $4,000, and was entirely phased out for filing units with income of $8,000. The EITC was not adjusted for inflation in 1975.

Thus, an eligible EITC recipient in 1975 with $4,000 of income ($16,844 in today's dollars) received the maximum $400 ($1,684 in today's dollars). In 2011, a similarly situated taxpayer (i.e., one with $16,844 in income) would receive today's maximum amounts if married ($3,094, $5,112, or $5,751 with one, two, or more than two children, respectively). An unmarried filer would receive just shy of these maximum amounts as his income is just over the start of the phaseout threshold of $16,690. In 1975, a taxpayer without children was not eligible for the EITC. In 2011, a taxpayer with $16,844 in income but without a qualifying child would be phased out of the EITC.

A taxpayer earning $8,000 in 1975 would receive no EITC, while a similarly situated taxpayer (i.e., one with $33,688 in income today) would receive $378, $1,532, or $2,171 if an unmarried filer with one, two, or more than two children, respectively. If married, the taxpayers would receive $1,190, $2,602, or $3,241 depending on whether he had one, two, or more than two children, respectively. In 2011, a taxpayer with $33,688 in income but without a qualifying child would be phased out of the EITC.

Child tax credit.–For 2011, the child tax credit generally is $1,000 for each qualifying child.[22] The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2012, is allowed against the AMT.

The child tax credit is phased out for individuals with income over certain thresholds. The phase out rate is $50 for each $1,000 of modified AGI[23] (or a fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

To the extent the child tax credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). For 2011, the

---

[21] Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings.

[22] A qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendant of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer.

[23] For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded under Code sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively).

child tax credit is refundable up to the greater of: (1) 15 percent of the taxpayer's earned income in excess of $3,000; or (2) for families with three or more children, the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income.

After 2012, the maximum child tax credit is $500 for each qualifying child and is only refundable for families with three or more children if the taxpayer's social security taxes exceed the taxpayer's earned income. The maximum child tax credit after 2012 is equivalent to the credit as originally enacted in the Taxpayer Relief Act of 1997.[24] Before 1997, taxpayers could not claim tax credits based solely on the number of dependent children. Instead, they were generally able to claim a personal exemption for each of these dependents. The Taxpayer Relief Act of 1997 provided for a child tax credit of $500 ($400 for 1998) for taxable years beginning after December 31, 1997. The Economic Growth and Tax Relief Reconciliation Act of 2001 increased the maximum child tax credit from $500 to $1000 over a number of years and made other changes to the child tax credit. [25]

Nonrefundable tax credits

Nonrefundable personal credits include the foreign tax credit, child and dependent care credit, education credits, retirement savings contributions credit, child tax credit, residential energy efficient property credit, nonbusiness energy property credit, and expenses of elderly or disabled.

Alternative minimum tax liability

In general

An alternative minimum tax is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. The tentative minimum tax is the sum of: (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are also used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's "tax preference items" and adjusted by redetermining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The exemption amounts for 2011 are: (1) $74,450 in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 in the case of unmarried individuals other than surviving spouses; (3) $37,225 in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust. The exemption amounts are phased out by an

---

[24] Pub. L. No. 105-34.

[25] Pub. L. No. 107-16.

amount equal to 25 percent of the amount by which the individual's AMTI exceeds: (1) $150,000 in the case of married individuals filing a joint return and surviving spouses; (2) $112,500 in the case of other unmarried individuals; and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Among the preferences and adjustments applicable to the individual alternative minimum tax are accelerated depreciation on certain property used in a trade or business, circulation expenditures, research and experimental expenditures, certain expenses and allowances related to oil and gas and mining exploration and development, certain tax-exempt interest income, and a portion of the amount of gain excluded with respect to the sale or disposition of certain small business stock. In addition, personal exemptions, the standard deduction, and certain itemized deductions, such as State and local taxes and miscellaneous deductions items, are not allowed to reduce alternative minimum taxable income.

B. Largest Tax Expenditures for Individuals

The following Table 3 shows the ten largest tax expenditures for individuals estimated for the period 2010-2014. The Appendix includes the top ten tax expenditures for five-year periods beginning with 1975-1979. Several items have consistently been among the top ten largest individual tax expenditures. Four have made the top ten lists in all eight of the five-year periods. These four items are: (1) the exclusion of employer contributions for health care and health insurance premiums; (2) the net exclusion of pension contributions and earnings: employer plans;[26] (3) the deduction for mortgage interest on owner-occupied homes; and (4) the deduction for nonbusiness State and local taxes (other than State and local property taxes on owner-occupied homes). Two items have been on the top ten list seven out of eight times: (1) the exclusion of untaxed Social Security and railroad retirement benefits, and (2) the deduction for charitable contributions. Two items have been on the top ten list six out of eight times: (1) the deduction for State and local property taxes on owner-occupied homes, and (2) the reduced rate of tax on dividends and long-term capital gains.[27]

---

[26] This item represents a combination of two items appearing on Table 3, (1) net exclusion of pension contributions and earnings: Defined benefit plans, and (2) net exclusion of pension contributions and earnings: Defined contribution plans, which are shown as a single combined item on the Tables for periods prior to 2010-2014 in the Appendix.

[27] Dividends have been included in this category for periods during which a reduced tax rate applies to them.

Table 3.–Largest Tax Expenditures, Individual 2010-2014

Tax Expenditure	Total Amount (2010-2014) (Billions of dollars)
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	659.4
Deduction for mortgage interest on owner-occupied homes	484.1
Reduced rates of tax on dividends and long-term capital gains	402.9
Net exclusion of pension contributions and earnings: Defined contribution plans	303.2
Earned income credit	268.8
Deduction of nonbusiness State and local government income, sales and personal property taxes	237.3
Net exclusion of pension contributions and earnings: Defined benefit plans	212.2
Exclusions of capital gains at death	194.0
Deductions for charitable contributions, other than for education and health	182.4
Exclusion of untaxed social security and railroad retirement benefits	173.0

III. OVERVIEW OF THE CORPORATE INCOME TAX

A. Structure of the Corporate Income Tax

Since its inception in 1909, the Federal income tax assessed on the earnings of corporations as entities separate and apart from their owners has undergone significant changes, both with respect to the corporate income tax rate structure and the tax base. The following very generally describes the corporate income tax as it exists today, an abbreviated history of the corporate income tax rates, and certain significant changes to the corporate income tax base.[28]

In general

Corporations organized under the laws of any of the 50 States (and the District of Columbia) generally are subject to the U.S. corporate income tax on their worldwide taxable income.[29]

The taxable income of a corporation generally is comprised of gross income less allowable deductions. Gross income generally is income derived from any source, including gross profit from the sale of goods and services to customers, rents, royalties, interest (other than interest from certain indebtedness issued by State and local governments), dividends, gains from the sale of business and investment assets, and other income.

Allowable deductions include ordinary and necessary business expenses, such as salaries, wages, contributions to profit-sharing and pension plans and other employee benefit programs, repairs, bad debts, taxes (other than Federal income taxes), contributions to charitable organizations (subject to an income limitation), advertising, interest expense, certain losses, selling expenses, and other expenses. Expenditures that produce benefits in future taxable years to a taxpayer's business or income-producing activities (such as the purchase of plant and equipment) generally are capitalized and recovered over time through depreciation, amortization or depletion allowances. A net operating loss incurred in one taxable year typically may be carried back two years or carried forward 20 years and allowed as a deduction in another taxable year. Deductions are also allowed for certain amounts despite the lack of a direct expenditure by the taxpayer. For example, a deduction is allowed for all or a portion of the amount of dividends received by a corporation from another corporation (provided certain ownership requirements are satisfied). Moreover, a deduction is allowed for a portion of the amount of income attributable to certain manufacturing activities.

---

[28] For a more information regarding corporate historic corporate tax rates and the corporate income tax base see the Appendix to this document, Joint Committee on Taxation, *Present Law and Background Relating to Selected Business Income Provisions* (JCX-34-11), June 1, 2011, and Joint Committee on Taxation, *Present Law and Historical Overview of the Federal Tax System* (JCX-1-11), January 18, 2011.

[29] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A foreign corporation generally is subject to the U.S. corporate income tax only on income with a sufficient nexus to the United States.

The Code also specifies certain expenses that typically may not be deducted, such as expenses associated with earning tax-exempt income,[30] certain entertainment expenses, certain executive compensation in excess of $1,000,000 per year, a portion of the interest on certain high-yield debt obligations that resemble equity, and fines, penalties, bribes, kickbacks and illegal payments.

In contrast to the treatment of capital gains in the individual income tax, no separate rate structure exists for corporate capital gains. Thus, the maximum rate of tax on the net capital gains of a corporation is 35 percent. A corporation may not deduct the amount of capital losses in excess of capital gains for any taxable year. Disallowed capital losses may be carried back three years or carried forward five years.

Like individuals, corporations may reduce their tax liability by any applicable tax credits. Tax credits applicable to businesses are listed in the Appendix, relating to the general business credit. Credits generally are determined based on a percentage of the cost associated with the underlying activity and generally are subject to certain limitations.

Affiliated group

Domestic corporations that are affiliated through 80 percent or more corporate ownership may elect to file a consolidated return in lieu of filing separate returns. For purposes of calculating tax liability, corporations filing a consolidated return generally are treated as divisions of a single corporation; thus, the losses (and credits) of one corporation generally can offset the income (and thus reduce the otherwise applicable tax) of other affiliated corporations.

Alternative minimum tax

A corporation is subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of a $40,000 exemption amount.[31] Credits that are allowed to offset a corporation's regular tax liability generally are not allowed to offset its minimum tax liability. If a corporation pays the alternative minimum tax, the amount of the tax paid is allowed as a credit against the regular tax in future years.

Alternative minimum taxable income is the corporation's taxable income increased by the corporation's tax preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. Among the preferences and adjustments applicable to the corporate alternative minimum tax are accelerated depreciation on certain property, certain expenses and allowances

---

[30] For example, the carrying costs of tax-exempt State and local obligations and the premiums on certain life insurance policies are not deductible.

[31] The exemption amount is phased out for corporations with income above certain thresholds, and is completely phased out for corporations with alternative minimum taxable income of $310,000 or more.

related to oil and gas and mining exploration and development, certain amortization expenses related to pollution control facilities, net operating losses and certain tax-exempt interest income. In addition, corporate alternative minimum taxable income is increased by 75 percent of the amount by which the corporation's "adjusted current earnings" exceeds its alternative minimum taxable income (determined without regard to this adjustment). Adjusted current earnings generally are determined with reference to the rules that apply in determining a corporation's earnings and profits.

A corporation with average annual gross receipts of not more than $7.5 million is exempt from the alternative minimum tax.

Treatment of corporate distributions

The taxation of a corporation generally is separate and distinct from the taxation of its shareholders. A distribution by a corporation to one of its shareholders generally is taxable as a dividend to the shareholder to the extent of the corporation's current or accumulated earnings and profits, and such a distribution is not a deductible expense of the corporation.[32] Thus, the amount of a corporate dividend generally is taxed twice: once when the income is earned by the corporation and again when the dividend is distributed to the shareholder.[33] Although subject to a second tax when distributed, shareholders in a corporation may benefit from deferral of this tax on undistributed corporate income (e.g., corporate income reinvested in the business).

Amounts received by a shareholder in complete liquidation of a corporation generally are treated as full payment in exchange for the shareholder's stock. A liquidating corporation recognizes gain or loss on the distributed property as if such property were sold to the distributee for its fair market value. However, if a corporation liquidates a subsidiary corporation of which it has 80 percent or more control, no gain or loss generally is recognized by either the parent corporation or the subsidiary corporation.

---

[32] A distribution in excess of the earnings and profits of a corporation generally is a tax-free return of capital to the shareholder to the extent of the shareholder's adjusted basis (generally, cost) in the stock of the corporation; such distribution is a capital gain if in excess of basis. A distribution of property other than cash generally is treated as a taxable sale of such property by the corporation and is taken into account by the shareholder at the property's fair market value. A distribution of common stock of the corporation generally is not a taxable event to either the corporation or the shareholder.

[33] This double taxation is mitigated by a reduced maximum tax rate of 15 percent generally applicable to dividend income of individuals (prior to 2013). Note that amounts paid as interest to the debtholders of a corporation generally are subject to only one level of tax (at the recipient level) because the corporation generally is allowed a deduction for the amount of interest expense paid or accrued.

Tax treatment of foreign activities of U.S. corporations[34]

The United States employs a worldwide tax system, under which domestic corporations generally are taxed on all income, whether derived in the United States or abroad. Income earned by a domestic parent corporation from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic parent corporation. Until that repatriation, the U.S. tax on the income generally is deferred. However, certain anti-deferral regimes may cause the domestic parent corporation to be taxed on a current basis in the United States on certain categories of passive or highly mobile income earned by its foreign corporate subsidiaries, regardless of whether the income has been distributed as a dividend to the domestic parent corporation. The main anti-deferral regimes in this context are the controlled foreign corporation rules of subpart F[35] and the passive foreign investment company rules.[36] A limited credit against U.S. tax is generally available for foreign tax imposed on foreign-source income, whether the income is earned directly by the domestic corporation, repatriated as an actual dividend, or included in the domestic parent corporation's income under one of the anti-deferral regimes.[37]

Corporate income tax rates

A corporation's regular income tax liability generally is determined by applying the appropriate tax rate to its taxable income. Table 4 below provides a compilation of the marginal rates of tax imposed on corporate income in 2011.

---

[34] For more information regarding the tax treatment of the foreign activities of U.S. corporations, see Joint Committee on Taxation, *Background and Selected Issues Related to the U.S. International Tax System and Systems that Exempt Foreign Business Income* (JCX-33-11), May 20, 2011; *Present Law and Issues in U.S. Taxation of Cross-Border Income* (JCX-42-11), September 6, 2011; *The Impact of International Tax Reform: Background and Selected Issues Relating to U.S. International Tax Rules and the Competitiveness of U.S Businesses* (JCX-22-06), June 21, 2006; and *Economic Efficiency and Structural Analyses of Alternative U.S. Tax Policies for Foreign Direct Investment* (JCX-55-08), June 25, 2008.

[35] Secs. 951-964.

[36] Secs. 1291-1298.

[37] Secs. 901, 902, 960, 1291(g).

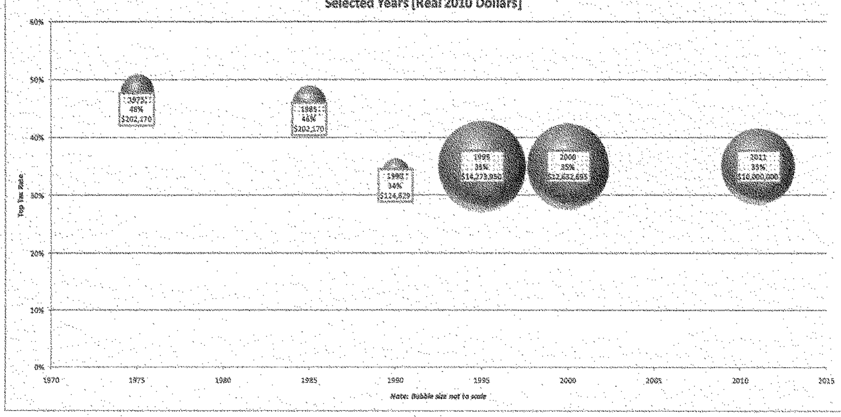
Table 4.–Federal Corporate Income Tax Rate Structure in 2011

Corporate Taxable Income	Income Tax Rate (percent)
First $50,000	15
$50,001-$75,000	25
$75,001-$100,000	34
$100,001-$335,000	39*
$335,001-$10,000,000	34
$10,000,001-$15,000,000	35
$15,000,001-$18,333,333	38*
Over $18,333,333	35

* Rates higher than the top bracket rate reflect phaseouts of the benefit from the lower bracket rates and are not technically the top corporate statutory rate.

Figure 12 below shows the top statutory corporate income tax rate and income threshold at which the rate begins to apply for selected years.

Figure 12.–Corporate Income Tax Top Rate and Bracket Threshold
Selected Years [Real 2010 Dollars]



Significant modifications to the corporate income tax base

The following discussion summarizes certain significant modifications to the corporate income tax base in the last few decades. In addition to affecting corporations, many of the Federal income tax provisions discussed below apply to all businesses.

Investment tax credit.–From 1962 through 1985 the Code from time to time allowed an investment tax credit. The investment tax credit was originally seven percent (three percent in the case of certain public utilities) of the cost of capital investments in new tangible personal property and certain depreciable real property. The investment tax credit was suspended during the years 1966 and from 1969-1971. The credit was revived in 1972 and then increased to a rate of ten percent in 1975. The Tax Reform Act of 1986 largely repealed the investment tax credit in an effort to equate effective tax rates with statutory tax rates and to rationalize the tax treatment of different assets.

Depreciation.–For Federal income tax purposes, a taxpayer is allowed to recover through annual depreciation deductions the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ("MACRS"). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The MACRS depreciation categories generally are set out in the Code and Internal Revenue Service guidance.[38]

Generally, the depreciation deduction calculation is a function of the capital investment in depreciable property, the recovery period, and the cost recovery method. Recovery periods and rates of recovery have varied over time. For example, prior to 1981, the depreciation system was based on estimated useful lives determined either by using facts and circumstances or by using guideline lives in Treasury guidance.[39] The useful lives were generally applied to calculate depreciation deductions using a straight-line method. The Economic Recovery Tax Act of 1981[40] replaced the prior law depreciation system with the Accelerated Cost Recovery System ("ACRS") which significantly accelerated depreciation on tangible property.[41] The Tax Reform Act of 1986 created MACRS. At times, Congress has enacted temporary bonus depreciation rules.

Section 179 expensing.–In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under section 179. The rules of section 179 were originally enacted in 1958 and the amount allowed to be expensed has generally increased over time.[42] Under a temporary provision enacted in 2010, for taxable years beginning in 2011, the maximum amount that a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2 million. For taxable years beginning in 2012 and

---

[38] Sec. 168; Rev. Proc. 87-56, 1987-2 C.B. 674.

[39] See Rev. Proc. 62-21, 1962-2 C.B. 418, for guideline useful lives.

[40] Pub. L. No. 97-34.

[41] Pub. L. No. 97-34, sec. 201.

[42] Pub. L. No. 85-866. sec. 204.

thereafter, the limitation amount is $125,000 and the phaseout threshold amount is $500,000, adjusted for inflation.

Amortization of goodwill and certain other intangible assets.–Prior to 1993, goodwill was not an amortizable asset and the amortization of other intangible assets was generally based on facts and circumstances. The Code was amended in 1993 to specify a 15-year amortization period for acquired goodwill and certain other intangible assets.[43]

Deduction for income attributable to domestic production activities.–The American Jobs Creation Act of 2004[44] created a deduction for income attributable to domestic production activities. The allowance of a deduction equal to a specified percentage of certain qualifying domestic production activities income has the effect of lowering the tax rate applicable to income from such activities. For taxable years beginning in 2005 or 2006, the deduction is three percent of the income from manufacturing, construction, and certain other activities specified in the Code. For taxable years beginning in 2007, 2008 and 2009, the deduction is equal to six percent. Beginning in 2010, the percentage is generally[45] nine percent.[46]

---

[43] Pub. L. No. 103-66.

[44] Pub. L. No. 108-357.

[45] In the case of oil related qualified production activities income, for any taxable year beginning after 2009, the percentage is reduced by three percent of the least of: (1) oil related qualified production activities income of the taxpayer for the taxable year; (2) qualified production activities income of the taxpayer for the taxable year; or (3) taxable income (determined without regard to the deduction for income attributable to domestic manufacturing activities).

[46] At the fully phased-in nine percent deduction, a corporation is taxed at a rate of 35 percent on only 91 percent of qualifying income, resulting in an effective tax rate on qualifying income of 31.85 percent (0.91 x 0.35 = 0.3185). A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

B. Overview of Business Entities Other Than Corporations

Significant business activity is conducted through entities other than corporations. Such business entities include passthrough entities such as partnerships (including limited liability companies ("LLCs")) and S corporations. For Federal income tax purposes, these passthrough entities generally are not subject to tax at the entity level. Rather, the owners – that is, partners or S corporation shareholders – are subject to tax on their shares of the entity's income, gain, loss, deduction, and credit, whether or not distributed.[47] The tax treatment of passthrough entities differs from the generally applicable entity level tax on income of C corporations. In addition, noncorporate business income is generated by sole proprietorships and farms.[48]

Allowable deductions for businesses conducted in passthrough entity form are generally the same as allowable deductions for businesses conducted in corporate form. However, the calculation of these deductions is affected by the fact that they are taken into account for tax purposes by the partners or S corporation shareholders rather than by the partnership or S corporation at the entity level.

There are no limitations on the identity of a partner in a partnership under present law. Thus, a partner in a business conducted through a partnership (including an LLC taxable as a partnership) can generally be an individual, a corporation, or another partnership, for example. Permissible shareholders of S corporations are restricted to individuals (other than nonresident aliens), estates, certain trusts, and certain tax-exempt organizations, and may not exceed 100 in number (taking into account applicable attribution rules).

[47] Partners and S corporation shareholders who are individuals generally report this income on Schedule E.

[48] This income is generally reported by individuals on Schedules C and F.

C. Largest Corporate Tax Expenditures

The following Table 5 shows the ten largest corporate tax expenditures estimated for the period 2010-2014. The Appendix includes top ten tax expenditures for five-year periods beginning with 1975-1979. Although the composition of the top ten lists has changed over time, two items have been in the list of top ten expenditures for the entire period: the exclusion of interest on general purpose State and local debt, and some form of accelerated depreciation.[49] Reduced rates for an initial amount of corporate income has been in the top ten since 1980-1985. A tax benefit for research expenses (either through a deduction or a tax credit) has been on the list for seven out of the eight periods.

Table 5.–Largest Tax Expenditures, Corporate 2010-2014

Tax Expenditure	Total Amount (2010-2014) (Billions of dollars)
Deferral of active income of controlled foreign corporations	70.6
Exclusion of interest on public purpose State and local government debt	45.3
Deduction for income attributable to domestic production activities	43.2
Inventory property sales source rule exception	38.0
Depreciation of equipment in excess of alternative depreciation system	37.1
Inclusion of income arising from business indebtedness discharged by the reacquisition of a debt instrument	28.8
Tax credit for low-income housing	27.0
Expensing of research and experimental expenditures	25.6
Inventory methods and valuation: Last in first out	20.0
Reduced rates for first $10,000,000 of corporate taxable income	15.9

[49] The tax expenditure item relating to accelerated depreciation (a function of asset basis, recovery period, and depreciation method) is a measure of the depreciation allowed in excess of the amount allowed in a normative system, though the terminology describing it has changed in the tax law over the years.

IV. REFORMING TAX EXPENDITURES AND THE NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM

A. The National Commission's General Approach to Tax Reform

In their report, the National Commission on Fiscal Responsibility and Reform (the "Commission") concluded that "[t]ax reform should lower tax rates, reduce the deficit, simplify the tax code, reduce the tax gap, and make America the best place to start a business and create jobs."[50] The Commission proposed eliminating most income tax expenditures and using the revenue to lower marginal tax rates and to reduce projected deficits. The proposed approach is consistent with much commentary over the years that a tax system with a broad base and low rates generally promotes market efficiency and growth.

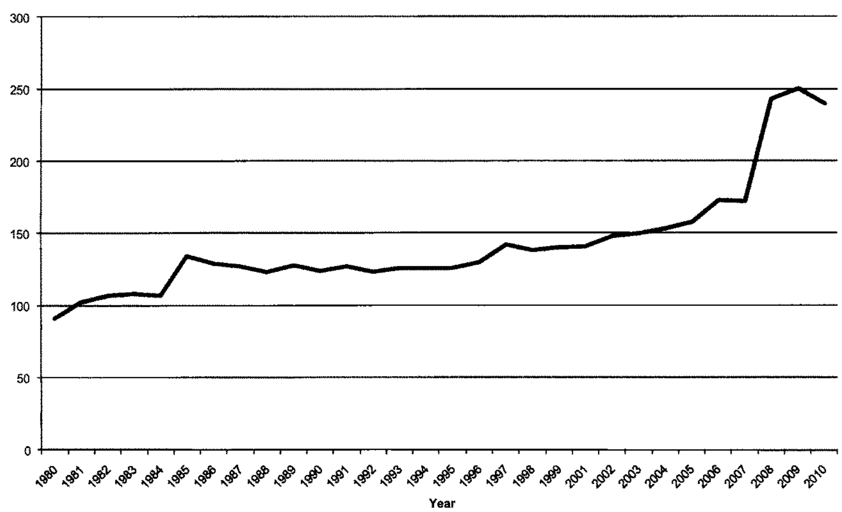
It is possible that part of the motivation of the Commission was the recognition of the growth in number and value of tax expenditures. Figure 13 below displays a simple count of provisions identified as tax expenditures with an estimated value in excess of $50 million as reported in the document published annually by the staff of the Joint Committee on Taxation.[51]

---

[50] The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, p. 28.

[51] The annual publication also lists other tax expenditure provisions, identified as quantitatively *de minimis* tax expenditures, that do not meet a $50 million threshold. The Appendix to this testimony includes a list of tax expenditures that have been added to the Code since the passage of the Tax Reform Act of 1986.

Figure 13.–Joint Committee on Taxation Count of Tax Expenditures, 1980-2010



Source: Joint Committee on Taxation staff.

B. Considerations for Congress in Assessing the National Commission's Approach

__Two concerns__

The course proposed by the Commission appears clear. However, I think it is important to emphasize today that the Commission's proposed course is not simply achieved. I say this for two reasons.

- First, it is not clear as a matter of crafting legislation what it means to eliminate all tax expenditures and start from a clean slate.
- Second, the dollar value of tax expenditures, as calculated by the staff of the Joint Committee on Taxation, is not the same as the estimated revenue effect to the Federal Treasury from elimination or reform of any such provision.

__What replaces a repealed tax expenditure?__

The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as "revenue losses attributable to provisions of the Federal tax law which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[52] Tax expenditures are defined relative to a more theoretically pure income tax. Thus, tax expenditures include any reductions in income tax liabilities that result from special tax provisions that provide tax benefits to particular taxpayers relative to this hypothetical income tax. Because the notion of a tax expenditure is measured against a hypothetical world, eliminating tax expenditures can involve many significant policy questions.

Example: home mortgage interest deduction

As noted above, one of the largest individual tax expenditure provisions is the deductibility of home mortgage interest expense by individuals. What does it mean to eliminate this tax expenditure? As of what date would mortgage interest no longer be deductible? Would the repeal apply to all existing mortgages or only to mortgages undertaken after the effective date? Either choice could be said to substantially eliminate the tax expenditure. These decisions will affect taxpayer's behavior regarding owning versus renting, the size of a home that they may choose to purchase, as well as the amount of debt they undertake and the choice of assets that they may retain in their portfolios. These decisions will affect the magnitude of revenues that redound to the Federal Treasury from the elimination of the tax expenditure and, as discussed below, these revenues will generally be less than the value of the estimated tax expenditure.

Example: employer de minimis fringe benefit--exercise room on site

Another example, while small in size, is employer de minimis fringe benefits. Currently, for example, the employer provision of an amenity like an exercise room on site is an allowable deductible expense for the business but is not included in the income of the employee. How would this tax expenditure be eliminated? Would the deduction be denied to the employer? Or would there be an attempt to value the benefit and require that it be included in the income of the employer?

Example: employer-provided pension benefits[53]

Another significant individual tax expenditure arises because pension benefits that accrue to individuals, either in defined contribution pension plans or in defined benefit pension plans, are not subject to the individual income tax. In the case of an employer's contribution to an individual's defined contribution pension plan, elimination of the tax expenditure could mean: counting the employer's specific dollar contribution as part of the individual's current taxable income. But the treatment of existing accounts is less clear. Would existing accounts still benefit from deferral of tax on earnings?

It is even less clear what elimination of this tax expenditure means in the context of a defined benefit accrual. Often the accrual value attributable to any specific individual depends upon economic outcomes that are not currently known to either the employer or the employee.

---

[52] Congressional Budget and Impoundment Control Act of 1974 (Pub. L. No. 93-344), sec. 3(3).

[53] The Commission did not propose eliminating this tax expenditure.

Specifically, the accrual value often depends upon the number of years of service that the employee ultimately provides to the employer and to the employee's as yet unknown highest salary level. How policymakers might develop the rules to value and tax this current tax expenditure benefit is not obvious.

Summary

These three examples demonstrate that eliminating many tax expenditures is not an easy legislative task. It is a task that involves many important decisions for policymakers.

Tax expenditure estimates compared to estimates of changed Federal revenues

A tax expenditure calculation is not the same as a revenue estimate for the repeal of the tax expenditure provision for three reasons. First, unlike revenue estimates, tax expenditure calculations do not incorporate the effects of the behavioral changes of affected individuals or entities that are anticipated to occur in response to the repeal of a tax expenditure provision. Second, tax expenditure calculations are concerned with changes in the reported tax liabilities of taxpayers. Because tax expenditure analysis focuses on tax liabilities as opposed to Federal government tax receipts, there is no concern for the short-term timing of tax payments. Revenue estimates are concerned with changes in Federal tax receipts that are affected by the timing of all tax payments. Third, some of the tax provisions that provide an exclusion from income also apply to the FICA tax base, and the repeal of the income tax provision would automatically increase FICA tax revenues as well as income tax revenues. This FICA effect would be reflected in revenue estimates, but is not considered in tax expenditure calculations. There may also be interactions between income tax provisions and other Federal taxes such as excise taxes and the estate and gift taxes.

If a tax expenditure provision were repealed, it is likely that the repeal would be made effective for taxable years beginning after a certain date. Because most individual taxpayers have taxable years that coincide with the calendar year, the repeal of a provision affecting the individual income tax most likely would be effective for taxable years beginning after December 31 of a certain year. However, the Federal government's fiscal year begins October 1. Thus, the revenue estimate for repeal of a provision would show a smaller revenue gain in the first fiscal year than in subsequent fiscal years. This is due to the fact that the repeal would be effective after the start of the Federal government's fiscal year. The revenue estimate might also reflect some delay in the timing of the revenue gains as a result of the taxpayer tendency to postpone or forgo changes in tax withholding and estimated tax payments, and very often repeal or modification of a tax provision includes transition relief that would not be captured in a tax expenditure calculation.

APPENDIX

A. Overview of Other Federal Taxes

1. Social insurance (employment) taxes

Social Security benefits and certain Medicare benefits are financed primarily by payroll taxes on covered wages and self-employment income. The Federal Insurance Contributions Act ("FICA") imposes a tax on employers based on the amount of wages paid to an employee during the year. The tax is composed of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($106,800 in 2011); and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages. In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer. For calendar year 2011, the employee OASDI rate is reduced by two percentage points to 4.2 percent. The employee tax generally must be withheld and remitted to the Federal government by the employer.[54] Self-employed taxpayers are subject to payroll tax under the Self-Employment Contributions Act ("SECA").

The earnings base is indexed each year automatically according to a statutory formula. Any increase in the earnings base is based on the increase in average wages in the economy.[55]

As part of the Omnibus Budget Reconciliation Act of 1993,[56] the earnings base for the HI portion of the tax was removed, making all earnings taxable for HI purposes, effective starting in 1994.

The social insurance tax rate and taxable wage base have increased over time. Table A-1 below shows the evolution of the taxable wage base and rates of tax since 1975.

---

[54] The OASDI and HI payroll tax is generally collected as a single tax with portions of it allocated by statute among three separate trust funds (OASI, DI and HI).

[55] The earnings base can only increase in a year in which there was an increase in benefits under the cost-of-living adjustment (COLA) formula. If there was no increase in benefits, the earnings base is prohibited from increasing. Sec. 230(a) of the Social Security Act. Since there was no increase in benefits from 2009 through 2011, the earnings base remained constant from 2009 through 2011 as well.

[56] Pub. L. No. 103-66.

Table A-1.–Social Insurance Taxable Wage Base and Rates of Tax

Year	Annual Maximum Taxable Wage Base	Contribution Rate for Both Employers and Employees (Percent of Covered Earnings)			Contribution Rate for Self-Employed Persons		
		Total	OASDI	HI	Total	OASDI	HI
1975	$14,100	5.85	4.95	0.9	7.9	7.0	0.9
1976	$15,300	5.85	4.95	0.9	7.9	7.0	0.9
1977	$16,500	5.85	4.95	0.9	7.9	7.0	0.9
1978	$17,700	6.05	5.05	1.00	8.1	7.1	1.0
1979	$22,900	6.13	5.08	1.05	8.1	7.05	1.05
1980	$25,900	6.13	5.08	1.05	8.1	7.05	1.05
1981	$29,700	6.65	5.35	1.3	9.3	8.0	1.3
1982	$32,400	6.7	5.4	1.3	9.35	8.05	1.3
1983	$35,700	6.7	5.4	1.3	9.35	8.05	1.3
1984[1]	$37,800	7.0	5.7	1.3	14.00	11.4	2.6
1985	$39,600	7.05	5.7	1.35	14.10	11.4	2.7
1986	$42,000	7.15	5.7	1.45	14.30	11.4	2.9
1987	$43,800	7.15	5.7	1.45	14.30	11.4	2.9
1988	$45,000	7.51	6.06	1.45	15.02	12.12	2.9
1989	$48,000	7.51	6.06	1.45	15.02	12.12	2.9
1990	$51,300	7.65	6.2	1.45	15.3	12.4	2.9
1991	$53,400	7.65	6.2	1.45	15.3	12.4	2.9
1992	$55,500	7.65	6.2	1.45	15.3	12.4	2.9
1993	$57,600	7.65	6.2	1.45	15.3	12.4	2.9
1994	$60,600	7.65	6.2	1.45	15.3	12.4	2.9
1995	$61,200	7.65	6.2	1.45	15.3	12.4	2.9
1996	$62,700	7.65	6.2	1.45	15.3	12.4	2.9
1997	$65,400	7.65	6.2	1.45	15.3	12.4	2.9
1998	$68,400	7.65	6.2	1.45	15.3	12.4	2.9
1999	$72,600	7.65	6.2	1.45	15.3	12.4	2.9
2000	$76,200	7.65	6.2	1.45	15.3	12.4	2.9
2001	$80,400	7.65	6.2	1.45	15.3	12.4	2.9
2002	$84,900	7.65	6.2	1.45	15.3	12.4	2.9
2003	$87,900	7.65	6.2	1.45	15.3	12.4	2.9
2004	$87,900	7.65	6.2	1.45	15.3	12.4	2.9
2005	$90,000	7.65	6.2	1.45	15.3	12.4	2.9
2006	$94,200	7.65	6.2	1.45	15.3	12.4	2.9
2007	$97,500	7.65	6.2	1.45	15.3	12.4	2.9
2008	$102,000	7.65	6.2	1.45	15.3	12.4	2.9
2009	$106,800	7.65	6.2	1.45	15.3	12.4	2.9
2010	$106,800	7.65	6.2	1.45	15.3	12.4	2.9
2011	$106,800	[2]	[2]	1.45	13.3	10.4	2.9

[1] For 1984 only, employees were allowed a credit of 0.3 percent of taxable wages against their FICA tax liability, reducing the effective rate to 6.7 percent.

[2] The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reduced the FICA tax rate for employees by two percentage points for 2011. Specifically, the employer OASDI rate remains at 6.2 while the employee rate is reduced to 4.2.

2. Estate and gift tax

The United States generally imposes a gift tax on transfers of property by gift made by a U.S. citizen or resident, whether made directly or indirectly and whether made in trust or otherwise.[57] Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. An estate tax generally is imposed on the taxable estate of any person who was a citizen or resident of the United States at the time of death and on certain property held by a nonresident alien if the property is located in the United States at the time of death.[58] The estate tax is imposed on the estate of the decedent and generally is based on the fair market value of the property passing at death. The taxable estate generally equals the worldwide gross estate less certain allowable deductions. Since 1976, a generation-skipping transfer tax also has been imposed on certain transfers to "skip persons," generally, beneficiaries in a generation more than one generation below that of the transferor.

Prior to 1976, the estate and gift tax systems were two separate systems. The Tax Reform Act of 1976[59] unified the estate and gift taxes, with a single graduated rate table for both cumulative inter vivos gifts and taxable transfers at death. Since that time, the top marginal estate and gift tax rate has decreased significantly, from 70 percent in 1977 to 35 percent in 2011. The 1976 Act also combined separate estate and gift tax exemptions into a single "unified credit," which effectively exempts a certain dollar value in gifts or bequests from gift or estate tax. The exemption value of the unified credit has increased significantly since that time, from $120,667 in 1977 to $5 million in 2011.[60]

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")[61] gradually reduced the estate and generation skipping transfer taxes through 2009, and generally repealed the estate and generation-skipping transfer taxes for one year in 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[62] generally reinstated the estate and generation-skipping transfer taxes for 2010, but allowed a decedent's executor to

[57] In determining their taxable gifts, taxpayers are permitted to exclude every year a specified dollar value of gifts to another person, provided the gift is a gift of a present interest in property. The gift tax annual exclusion has increased over time, from $3,000 in 1975 to $13,000 in 2011.

[58] Assets acquired from a decedent generally receive a fair market value ("stepped up") basis. In general, the tax basis of assets acquired by gift is carried over from the donor of the gift. Gifts and bequests generally are excluded from the recipient's gross income for income tax purposes.

[59] Pub. L. No. 94-455.

[60] Through 1976, and again from 2004 through 2010, the exemption value of the unified credit for estate and gift tax purposes differed. The generation-skipping transfer tax rate equals the highest marginal estate tax rate, and the generation-skipping transfer tax exemption equals the estate tax exemption in effect for the year.

[61] Pub. L. No. 107-16.

[62] Pub. L. No. 111-312.

elect out of the new regime (such that an estate tax would not apply); the Act set the generation-skipping transfer tax rate at zero percent.

The estate and gift tax laws include special rules, which have become more generous over time, for gifts or bequests to a spouse. Prior to 1976, for example, a marital deduction was permitted for 50 percent of the value of property transferred through an estate from a deceased spouse to the surviving spouse. The 1976 Act provided a 100-percent marital deduction for the first $250,000 of property transferred to a surviving spouse. Since 1981, the estate and gift tax laws generally have provided for unlimited deductions for gifts and bequests to spouses.

The estate and gift tax laws also include a number of special, preferential rules for transfers of interests in closely held businesses and farms, including special valuation rules and rules that allow for installment payment of estate taxes under certain circumstances. For example, a provision included in the 1976 Act generally permits a decedent's executor to value farm and other business real property for estate tax purposes at its current-use value instead of at its highest and best use value for estate tax purposes, subject to a maximum reduction in value.[63] This maximum reduction in value subject to tax has increased over time, from $500,000 in 1981 to $1 million in 2011.

Table A-2 below shows the evolution since 1975 of the gift tax annual exclusion, the estate and gift tax exemptions, the highest statutory estate and gift tax rates, and the threshold above which such rates apply.

Table A-2.–Estate and Gift Tax Rates and Exemption Amounts, 1975-2011

Year	Annual gift exclusion	Exemption value of unified credit (gift exemption when not unified)	Threshold of highest statutory tax rate	Highest statutory tax rate (percent)
1975-1976	$3,000	$60,000 ($30,000)	$10 million	57.75 gift; 77 estate
1977	$3,000	$120,667	$5 million	70
1978	$3,000	$134,000	$5 million	70
1979	$3,000	$147,333	$5 million	70
1980	$3,000	$161,563	$5 million	70
1981	$10,000	$175,625	$5 million	70
1982	$10,000	$225,000	$4 million	65
1983	$10,000	$275,000	$3.5 million	60
1984	$10,000	$325,000	$3 million	55
1985	$10,000	$400,000	$3 million	55
1986	$10,000	$500,000	$3 million	55
1987-1997	$10,000	$600,000	$3 million	55
1998	$10,000	$625,000	$3 million	55

[63] Sec. 2032A.

Year	Annual gift exclusion	Exemption value of unified credit (gift exemption when not unified)	Threshold of highest statutory tax rate	Highest statutory tax rate (percent)
1999	$10,000	$650,000	$3 million	55
2000-2001	$10,000	$675,000	$3 million	55
2002	$11,000	$1 million	$2.5 million	50
2003	$11,000	$1 million	$2 million	49
2004	$11,000	$1.5 million ($1 million)	$2 million	48
2005	$11,000	$1.5 million ($1 million)	$2 million	47
2006	$12,000	$2 million ($1 million)	$2 million	46
2007-2008	$12,000	$2 million ($1 million)	$1.5 million	45
2009	$13,000	$3.5 million ($1 million)	$1.5 million	45
2010[64]	$13,000	$5 million ($1 million)	$500,000[65]	35
2011	$13,000	$5 million	$500,000[66]	35

3. Excise taxes

In general

The Federal tax system imposes excise taxes on selected goods and services.[67] In addition to excise taxes the primary purpose of which is revenue production, excise taxes also are imposed to promote adherence to other policies (e.g., penalty excise taxes). Generally, excise taxes are taxes imposed on a per unit or ad valorem (i.e., percentage of price) basis on the

[64] Under the 2010 Act, executors of estates of decedents who die during 2010 generally may elect to have the EGTRRA 2010 estate tax and basis rules apply as if the estate tax provisions of the 2010 Act had never been enacted. In the event of such an election: (1) no estate tax would apply; (2) the generation skipping transfer tax would remain in effect with a $5 million exemption and a zero-percent rate; (3) The gift tax exemption and rate would be $1 million and 35 percent; and (4) basis of assets acquired from the decedent would take a modified carry-over basis under section 1022.

[65] The 2010 Act modifies the rate table in section 2001(c) to provide for a $500,000 threshold for the highest statutory rate of 35 percent. However, the estate and gift tax exemptions for 2010 exceed this threshold amount, with the result that any transfers up to the exemption amounts will not be taxed. Therefore, in practice, the 35-percent rate applies only to 2010 transfers that exceed a taxpayer's estate or gift tax exemptions, and any lower marginal rates listed in the section 2001(c) rate table will not apply.

[66] The 2010 Act modifies the rate table in section 2001(c) to provide for a $500,000 threshold for the highest statutory rate of 35 percent. However, the estate and gift tax exemptions for 2011 exceed this threshold amount, with the result that any transfers up to the exemption amounts will not be taxed. Therefore, in practice, the 35-percent rate applies only to 2011 transfers that exceed a taxpayer's estate or gift tax exemptions, and any lower marginal rates listed in the section 2001(c) rate table will not apply.

[67] For a more detailed description of Federal excise taxes, see, Joint Committee on Taxation, *Present Law and Background Information on Federal Excise Taxes* (JCS-1-11), January 2011.

production, importation, or sale of a specific good or service. Among the goods and services subject to U.S. excise taxes are motor fuels, alcoholic beverages, tobacco products, firearms, air and ship transportation, certain environmentally hazardous activities and products, coal, telephone communications, certain wagers, and vehicles lacking in fuel efficiency.[68]

In 2010, the Congress enacted several new excise taxes. These taxes are: the Patient-Centered Outcomes Research Trust Fund taxes;[69] the annual fee on branded prescription pharmaceutical manufacturers and importers;[70] the excise tax on indoor tanning services;[71] the excise tax on certain medical devices;[72] the annual fee on health insurance providers;[73] the excise taxes on individuals without minimum essential health coverage;[74] the excise tax on certain large employers not offering health care coverage;[75] the excise tax on insurers for high-cost employer-sponsored health coverage;[76] and the foreign procurement excise tax.[77]

Revenues from certain Federal excise taxes are dedicated to trust funds (e.g., the Highway Trust Fund) for designated expenditure programs. Revenues from other excise taxes (e.g., alcoholic beverages) go to the General Fund for general purpose expenditures.

The largest excise taxes in terms of revenue (for fiscal year 2009) are those for gasoline motor fuels ($25.1 billion), domestic cigarettes ($11.0 billion), diesel motor fuel ($8.5 billion), and domestic air ticket taxes ($7.3 billion).

The following summarizes the key changes to the alcohol, cigarette, and motor fuel excise taxes since 1975.

---

[68] See Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986* (JCS-3-01), April 2001, pp. 478-516 for discussion of various Federal excise taxes.

[69] Sec. 4375 (relating to health insurance); and sec. 4376 (relating to self-insured health plans).

[70] Sec. 9008 of Pub. L. No 111-148, as amended by sec. 1404 of Pub. L. No. 111-152.

[71] Sec. 5000B.

[72] Sec. 4191.

[73] Sec. 9010 of Pub. L. No. 111-148, as amended by sec. 10905 of such Act, as further amended by sec. 1406 of Pub. L. No. 111-152.

[74] Sec. 5000A.

[75] Sec. 4980H.

[76] Sec. 4980I.

[77] Sec. 5000C.

Alcohol

Taxes are imposed at different rates for distilled spirits, beer, and wines, and are imposed on these products when produced or imported. Table A-3 below shows the alcohol excise tax rates since 1975.

A-3.–Alcohol Excise Taxes

Type of Alcohol	1975	1985	1990-Present
Distilled Spirits (per proof gallon)	$10.50	$12.50	$13.50
Beer (per barrel)	9.0	9.0	18.0
Wines (per wine gallon)			
"Still wines" not more than 14 percent alcohol	.17	.17	1.07
"Still wines" 14-21% alcohol	.67	.67	1.57
"Still wines" 21-24% alcohol	2.25	2.25	3.15
"Still wines" more than 24% alcohol	Taxed as spirits	Taxed as Spirits	Taxed as Spirits
Champagne and sparkling wines	3.40	3.40	3.40
Artificially carbonated wines	2.40	2.40	3.30

Cigarettes

In 1975 the excise tax rate on small cigarettes was eight cents per pack, the same rate that had been in effect since 1951.[78] Table A-4 below shows the cigarette excise tax rates since 1975.

Table A-4.–Cigarette Excise Tax Rates

Year	1975 - 1981	1982 - 1990	1991 - 1992	1993 - 1996	1997 - 2008	2009 - Present
Small Cigarettes Tax Rate (cents per pack)	8	16	20	24	39	100.66

Motor fuels

The tax on gasoline in 1975 was four cents per gallon and the revenues raised from the tax were allocated to the Highway Trust Fund ("HTF"), created by the Highway Revenue Act of

[78] Small cigarettes are those weighing three pounds or less per thousand.

1956.[79] The tax on diesel fuel was also four cents per gallon in 1975. Table A-5 below shows motor fuel excise tax rates since 1975.

Table A-5.–Motor Fuel Excise Tax Rates

Year	1975	1983	1984	1987	1990	1993-Present(1)
Gasoline (cents per gallon)	4	9	9	9.1	14.1	18.4
Diesel (cents per gallon)	4	9	15	15.1	20.1	24.4

[1] The current gasoline and diesel rates of 18.4 cents per gallon and 24.4 cents per gallon, respectively, consist of 18.3 cents per gallon (gasoline) and 24.3 cents per gallon (diesel) allocated to the HTF, and 0.1 cent per gallon allocated to the Leaking Underground Storage Tank Trust Fund.

[79] Pub. L. No. 84-627.

B. Historical Federal Receipts by Source - Supplemental Material

Tables A-6 through A-8 below show data from 1950 to 2010 on the aggregate receipts collected from the individual income tax, the corporate income tax, social insurance taxes, excise taxes, the estate and gift taxes, and other receipts. Table A-6 shows the aggregate revenues collected by source, in millions of dollars.

Table A-7 shows the same aggregate revenues by source, but as a percentage of Gross Domestic Product ("GDP"). As a share of GDP, the individual income tax has generally oscillated around its average value of eight percent over this period of time. By contrast, corporate income taxes and excise taxes have generally declined as a share of GDP during this period, while social insurance taxes have risen substantially as a share of GDP over this period. In 2010, total taxes averaged 14.9 percent of GDP, well below the average of the 1950-2010 period of 17.9 percent.

Table A-8 shows Federal receipts by source as a percentage of all Federal receipts. Reflecting the same facts as above, the individual income tax has oscillated around its average share over this period of 44.8 percent, the corporate and excise taxes have declined as a percentage of all revenues, and social insurance taxes have risen substantially from around 10 percent of the total in the early 1950s to levels generally varying between 35 and 40 percent in recent years. Social insurance taxes as a share of all taxes reached a historic high of 42.3 percent in 2009, owing to sharp declines in individual and corporate income taxes.

Figure A-1 shows the components of adjusted gross income as a percentage of total adjusted gross income from 1950 to 2008. Since 1980, salary and wage income has fallen as a share of adjusted gross income, while business net income has risen substantially.

Table A-6.–Aggregate Federal Receipts by Source, 1950-2010
[millions of dollars]

Fiscal Year	Individual Income Tax	Corporate Income Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts	Total
1950	15,755	10,449	4,338	7,550	698	653	39,443
1951	21,616	14,101	5,674	8,648	708	870	51,616
1952	27,934	21,226	6,445	8,852	818	892	66,167
1953	29,816	21,238	6,820	9,877	881	976	69,608
1954	29,542	21,101	7,208	9,945	934	971	69,701
1955	28,747	17,861	7,862	9,131	924	926	65,451
1956	32,188	20,880	9,320	9,929	1,161	1,109	74,587
1957	35,620	21,167	9,997	10,534	1,365	1,307	79,990
1958	34,724	20,074	11,239	10,638	1,393	1,568	79,636
1959	36,719	17,309	11,722	10,578	1,333	1,588	79,249
1960	40,715	21,494	14,683	11,676	1,606	2,317	92,492
1961	41,338	20,954	16,439	11,860	1,896	1,900	94,388
1962	45,571	20,523	17,046	12,534	2,016	1,985	99,676
1963	47,588	21,579	19,804	13,194	2,167	2,228	106,560
1964	48,697	23,493	21,963	13,731	2,394	2,337	112,613
1965	48,792	25,461	22,242	14,570	2,716	3,037	116,817
1966	55,446	30,073	25,546	13,062	3,066	3,642	130,835
1967	61,526	33,971	32,619	13,719	2,978	4,009	148,822
1968	68,726	28,665	33,923	14,079	3,051	4,529	152,973
1969	87,249	36,678	39,015	15,222	3,491	5,227	186,882
1970	90,412	32,829	44,362	15,705	3,644	5,855	192,807
1971	86,230	26,785	47,325	16,614	3,735	6,450	187,139
1972	94,737	32,166	52,574	15,477	5,436	6,919	207,309
1973	103,246	36,153	63,115	16,260	4,917	7,109	230,799
1974	118,952	38,650	75,071	16,844	5,035	8,702	263,224
1975	122,386	40,621	84,534	16,551	4,611	10,387	279,090
1976	131,603	41,409	90,769	16,963	5,216	12,101	298,060
1977	157,626	54,892	106,485	17,548	7,327	11,681	355,559
1978	180,988	59,952	120,967	18,376	5,285	13,993	399,561
1979	217,841	65,677	138,939	18,745	5,411	16,690	463,302
1980	244,069	64,600	157,803	24,329	6,389	19,922	517,112
1981	285,917	61,137	182,720	40,839	6,787	21,872	599,272
1982	297,744	49,207	201,498	36,311	7,991	25,015	617,766
1983	288,938	37,022	208,994	35,300	6,053	24,256	600,562
1984	298,415	56,893	239,376	37,361	6,010	28,382	666,438
1985	334,531	61,331	265,163	35,992	6,422	30,598	734,037
1986	348,959	63,143	283,901	32,919	6,958	33,275	769,155
1987	392,557	83,926	303,318	32,457	7,493	34,536	854,288
1988	401,181	94,508	334,335	35,227	7,594	36,393	909,238
1989	445,690	103,291	359,416	34,386	8,745	39,576	991,105
1990	466,884	93,507	380,047	35,345	11,500	44,674	1,031,958
1991	467,827	98,086	396,016	42,402	11,138	39,519	1,054,988
1992	475,964	100,270	413,689	45,569	11,143	44,574	1,091,208
1993	509,680	117,520	428,300	48,057	12,577	38,201	1,154,335
1994	543,055	140,385	461,475	55,225	15,225	43,202	1,258,566
1995	590,244	157,004	484,473	57,484	14,763	47,822	1,351,790
1996	656,417	171,824	509,414	54,014	17,189	44,195	1,453,053
1997	737,466	182,293	539,371	56,924	19,845	43,333	1,579,232
1998	828,586	188,677	571,831	57,673	24,076	50,885	1,721,728
1999	879,480	184,680	611,833	70,414	27,782	53,263	1,827,452
2000	1,004,462	207,289	652,852	68,865	29,010	62,713	2,025,191
2001	994,339	151,075	693,967	66,232	28,400	57,069	1,991,082
2002	858,345	148,044	700,760	66,989	26,507	52,491	1,853,136
2003	793,699	131,778	712,978	67,524	21,959	54,376	1,782,314
2004	808,959	189,371	733,407	69,855	24,831	53,691	1,880,114
2005	927,222	278,282	794,125	73,094	24,764	56,124	2,153,611
2006	1,043,908	353,915	837,821	73,961	27,877	69,387	2,406,869
2007	1,163,472	370,243	869,607	65,069	26,044	73,550	2,567,985
2008	1,145,747	304,346	900,155	67,334	28,844	77,565	2,523,991
2009	915,308	138,229	890,917	62,483	23,482	74,570	2,104,989
2010	898,549	191,437	864,814	66,909	18,885	122,130	2,162,724

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad social security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of [1] customs duties and fees, and [2] deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2012, Tables 2.1 and 2.5, and JCT calculations.*

Table A-7.–Federal Receipts by Source, As a Percentage of GDP, 1950-2010

Fiscal Year	Individual Income Tax	Corporate Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts	Total
1950	5.8	3.8	1.6	2.8	0.3	0.2	14.4
1951	6.8	4.4	1.8	2.7	0.2	0.3	16.1
1952	8.0	6.1	1.8	2.5	0.2	0.3	19.0
1953	8.0	5.7	1.8	2.7	0.2	0.3	18.7
1954	7.8	5.6	1.9	2.6	0.2	0.3	18.5
1955	7.3	4.5	2.0	2.3	0.2	0.2	16.5
1956	7.5	4.9	2.2	2.3	0.3	0.3	17.5
1957	7.9	4.7	2.2	2.3	0.3	0.3	17.7
1958	7.5	4.4	2.4	2.3	0.3	0.3	17.3
1959	7.5	3.5	2.4	2.2	0.3	0.3	16.2
1960	7.8	4.1	2.8	2.3	0.3	0.4	17.8
1961	7.8	4.0	3.1	2.2	0.4	0.4	17.8
1962	8.0	3.6	3.0	2.2	0.4	0.3	17.6
1963	7.9	3.6	3.3	2.2	0.4	0.4	17.8
1964	7.6	3.7	3.4	2.1	0.4	0.4	17.6
1965	7.1	3.7	3.2	2.1	0.4	0.4	17.0
1966	7.3	4.0	3.4	1.7	0.4	0.5	17.3
1967	7.6	4.2	4.0	1.7	0.4	0.5	18.4
1968	7.9	3.3	3.9	1.6	0.4	0.5	17.6
1969	9.2	3.9	4.1	1.6	0.4	0.6	19.7
1970	8.9	3.2	4.4	1.6	0.4	0.6	19.0
1971	8.0	2.5	4.4	1.5	0.3	0.6	17.3
1972	8.1	2.7	4.5	1.3	0.5	0.6	17.6
1973	7.9	2.8	4.8	1.2	0.4	0.5	17.6
1974	8.3	2.7	5.2	1.2	0.4	0.6	18.3
1975	7.8	2.6	5.4	1.1	0.3	0.7	17.9
1976	7.6	2.4	5.2	1.0	0.3	0.7	17.1
1977	8.0	2.8	5.4	0.9	0.4	0.6	18.0
1978	8.2	2.7	5.5	0.8	0.2	0.6	18.0
1979	8.7	2.6	5.6	0.7	0.2	0.7	18.5
1980	9.0	2.4	5.8	0.9	0.2	0.7	19.0
1981	9.4	2.0	6.0	1.3	0.2	0.7	19.6
1982	9.2	1.5	6.3	1.1	0.2	0.8	19.2
1983	8.4	1.1	6.1	1.0	0.2	0.7	17.5
1984	7.8	1.5	6.2	1.0	0.2	0.7	17.3
1985	8.1	1.5	6.4	0.9	0.2	0.7	17.7
1986	7.9	1.4	6.4	0.7	0.2	0.8	17.5
1987	8.4	1.8	6.5	0.7	0.2	0.7	18.4
1988	8.0	1.9	6.7	0.7	0.2	0.7	18.2
1989	8.3	1.9	6.7	0.6	0.2	0.7	18.4
1990	8.1	1.6	6.6	0.6	0.2	0.8	18.0
1991	7.9	1.7	6.7	0.7	0.2	0.7	17.8
1992	7.6	1.6	6.6	0.7	0.2	0.7	17.5
1993	7.7	1.8	6.5	0.7	0.2	0.6	17.5
1994	7.8	2.0	6.6	0.8	0.2	0.6	18.0
1995	8.0	2.1	6.6	0.8	0.2	0.7	18.4
1996	8.5	2.2	6.6	0.7	0.2	0.6	18.8
1997	9.0	2.2	6.6	0.7	0.2	0.5	19.2
1998	9.6	2.2	6.6	0.7	0.3	0.6	19.9
1999	9.6	2.0	6.6	0.8	0.3	0.6	19.8
2000	10.2	2.1	6.6	0.7	0.3	0.6	20.6
2001	9.7	1.5	6.8	0.6	0.3	0.6	19.5
2002	8.1	1.4	6.6	0.6	0.3	0.5	17.6
2003	7.2	1.2	6.5	0.6	0.2	0.5	16.2
2004	6.9	1.6	6.3	0.6	0.2	0.5	16.1
2005	7.5	2.2	6.4	0.6	0.2	0.5	17.3
2006	7.9	2.7	6.3	0.6	0.2	0.5	18.2
2007	8.4	2.7	6.3	0.5	0.2	0.5	18.5
2008	8.0	2.1	6.3	0.5	0.2	0.5	17.5
2009	6.5	1.0	6.3	0.4	0.2	0.5	14.9
2010	6.2	1.3	6.0	0.5	0.1	0.8	14.9
1950-2010 Avg.	8.0	2.8	5.0	1.3	0.3	0.5	17.9

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad Social Security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of (1) customs duties and fees, and (2) deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2012, Table 2.3;* Economic Report of the President, 2011, Table B-78 for fiscal year GDP Figures.

Table A-8.–Federal Receipts by Source, As a Percentage of Total Revenues, 1950-2010

Fiscal Year	Individual Income Tax	Corporate Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts
1950	39.9	26.5	11.0	19.1	1.8	1.7
1951	41.9	27.3	11.0	16.8	1.4	1.7
1952	42.2	32.1	9.7	13.4	1.2	1.3
1953	42.8	30.5	9.8	14.2	1.3	1.4
1954	42.4	30.3	10.3	14.3	1.3	1.4
1955	43.9	27.3	12.0	14.0	1.4	1.4
1956	43.2	28.0	12.5	13.3	1.6	1.5
1957	44.5	26.5	12.5	13.2	1.7	1.6
1958	43.6	25.2	14.1	13.4	1.7	2.0
1959	46.3	21.8	14.8	13.3	1.7	2.0
1960	44.0	23.2	15.9	12.6	1.7	2.5
1961	43.8	22.2	17.4	12.6	2.0	2.0
1962	45.7	20.6	17.1	12.6	2.0	2.0
1963	44.7	20.3	18.6	12.4	2.0	2.1
1964	43.2	20.9	19.5	12.2	2.1	2.1
1965	41.8	21.8	19.0	12.5	2.3	2.6
1966	42.4	23.0	19.5	10.0	2.3	2.8
1967	41.3	22.8	21.9	9.2	2.0	2.7
1968	44.9	18.7	22.2	9.2	2.0	3.0
1969	46.7	19.6	20.9	8.1	1.9	2.8
1970	46.9	17.0	23.0	8.1	1.9	3.0
1971	46.1	14.3	25.3	8.9	2.0	3.4
1972	45.7	15.5	25.4	7.5	2.6	3.3
1973	44.7	15.7	27.3	7.0	2.1	3.1
1974	45.2	14.7	28.5	6.4	1.9	3.3
1975	43.9	14.6	30.3	5.9	1.7	3.7
1976	44.2	13.9	30.5	5.7	1.7	4.1
1977	44.3	15.4	29.9	4.9	2.1	3.3
1978	45.3	15.0	30.3	4.6	1.3	3.5
1979	47.0	14.2	30.0	4.0	1.2	3.6
1980	47.2	12.5	30.5	4.7	1.2	3.9
1981	47.7	10.2	30.5	6.8	1.1	3.6
1982	48.2	8.0	32.6	5.9	1.3	4.0
1983	48.1	6.2	34.8	5.9	1.0	4.0
1984	44.8	8.5	35.9	5.6	0.9	4.3
1985	45.6	8.4	36.1	4.9	0.9	4.2
1986	45.4	8.2	36.9	4.3	0.9	4.3
1987	46.0	9.8	35.5	3.8	0.9	4.0
1988	44.1	10.4	36.8	3.9	0.8	4.0
1989	45.0	10.4	36.3	3.5	0.9	4.0
1990	45.2	9.1	36.8	3.4	1.1	4.3
1991	44.3	9.3	37.5	4.0	1.1	3.7
1992	43.6	9.2	37.9	4.2	1.0	4.1
1993	44.2	10.2	37.1	4.2	1.1	3.3
1994	43.1	11.2	36.7	4.4	1.2	3.4
1995	43.7	11.6	35.8	4.3	1.1	3.5
1996	45.2	11.8	35.1	3.7	1.2	3.0
1997	46.7	11.5	34.2	3.6	1.3	2.7
1998	48.1	11.0	33.2	3.3	1.4	3.0
1999	48.1	10.1	33.5	3.9	1.5	2.9
2000	49.6	10.2	32.2	3.4	1.4	3.1
2001	49.9	7.6	34.9	3.3	1.4	2.9
2002	46.3	8.0	37.8	3.6	1.4	2.8
2003	44.5	7.4	40.0	3.8	1.2	3.1
2004	43.0	10.1	39.0	3.7	1.3	2.9
2005	43.1	12.9	36.9	3.4	1.1	2.6
2006	43.4	14.7	34.8	3.1	1.2	2.9
2007	45.3	14.4	33.9	2.5	1.0	2.9
2008	45.4	12.1	35.7	2.7	1.1	3.1
2009	43.5	6.6	42.3	3.0	1.1	3.5
2010	41.5	8.9	40.0	3.1	0.9	5.6
1950-2010 Avg.	44.8	15.7	27.7	7.3	1.5	3.0

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad Social Security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of (1) customs duties and fees, and (2) deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2012, Table 2.2.*

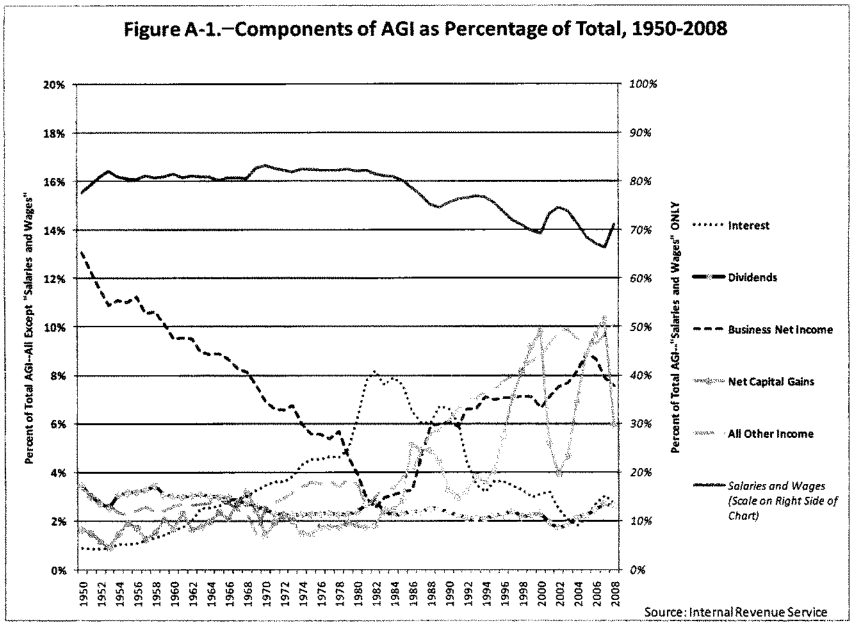


Figure A-1.–Components of AGI as Percentage of Total, 1950-2008
Percent of Total AGI--All Except "Salaries and Wages"
Percent of Total AGI--"Salaries and Wages" ONLY
Interest
Dividends
Business Net Income
Net Capital Gains
All Other Income
Salaries and Wages (Scale on Right Side of Chart)
Source: Internal Revenue Service

C. Variety of Business Organizations - Supplemental Data

Table A-9.–Number of Different Types of Business Returns, 1978-2008

Year	Non-Farm Sole Props	C Corporations	S Corporations	Partnerships	Farms	Total
1978	8,908,289	1,898,100	478,679	1,234,157	2,704,794	15,224,019
1979	9,343,603	2,041,887	514,907	1,299,593	2,605,684	15,805,674
1980	9,730,019	2,165,149	545,389	1,379,654	2,608,430	16,428,641
1981	9,584,790	2,270,931	541,489	1,460,502	2,641,254	16,498,966
1982	10,105,515	2,361,714	564,219	1,514,212	2,689,237	17,234,897
1983	10,703,921	2,350,804	648,267	1,541,539	2,710,044	17,954,575
1984	11,262,390	2,469,404	701,339	1,643,581	2,694,420	18,771,134
1985	11,928,573	2,552,470	724,749	1,713,603	2,620,861	19,540,256
1986	12,393,700	2,602,301	826,214	1,702,952	2,524,331	20,049,498
1987	13,091,132	2,484,228	1,127,905	1,648,035	2,420,186	20,771,486
1988	13,679,302	2,305,598	1,257,191	1,654,245	2,367,527	21,263,863
1989	14,297,558	2,204,896	1,422,967	1,635,164	2,359,718	21,920,303
1990	14,782,738	2,141,558	1,575,092	1,553,529	2,321,153	22,374,070
1991	15,180,722	2,105,200	1,696,927	1,515,345	2,290,908	22,789,102
1992	15,495,419	2,083,652	1,785,371	1,484,752	2,288,218	23,137,412
1993	15,848,119	2,063,124	1,901,505	1,467,567	2,272,407	23,552,722
1994	16,153,871	2,318,614	2,023,754	1,493,963	2,242,324	24,232,526
1995	16,423,872	2,321,048	2,153,119	1,580,900	2,219,244	24,698,183
1996	16,955,023	2,326,954	2,304,416	1,654,256	2,188,025	25,428,674
1997	17,176,486	2,257,829	2,452,254	1,758,627	2,160,954	25,806,150
1998	17,398,440	2,260,757	2,588,081	1,855,348	2,091,845	26,194,471
1999	17,575,643	2,210,129	2,725,775	1,936,919	2,067,883	26,516,349
2000	17,902,791	2,184,795	2,860,478	2,057,500	2,086,789	27,092,353
2001	18,338,190	2,149,105	2,986,486	2,132,117	2,006,871	27,612,769
2002	18,925,517	2,112,230	3,154,377	2,242,169	1,995,072	28,429,365
2003	19,710,079	2,059,631	3,341,606	2,375,375	1,997,116	29,483,807
2004	20,590,691	2,039,631	3,518,334	2,546,877	2,004,898	30,700,431
2005	21,467,566	1,987,171	3,684,086	2,763,625	1,981,249	31,883,697
2006	22,074,953	1,968,032	3,872,766	2,947,116	1,958,273	32,821,140
2007	23,122,698	1,878,956	3,989,893	3,096,334	1,989,690	34,077,571
2008	22,614,483	1,797,278	4,049,943	3,146,006	1,948,054	33,555,764

Source: Internal Revenue Service, Statistics of Income, published and unpublished data.

Table A-10.– Distribution of C Corporations, 2008

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent Returns	Cumulative Percent Total Assets
$0 or less	296,074	0	16.47%	0.00%
$1 to $25,000	363,899	2,668	36.72%	0.00%
$25,001 to $50,000	136,343	4,695	44.31%	0.01%
$50,001 to $100,000	174,776	11,908	54.03%	0.03%
$100,001 to $250,000	253,837	39,698	68.15%	0.08%
$250,001 to $500,000	181,186	64,539	78.24%	0.17%
$500,001 to $1,000,000	139,966	98,766	86.02%	0.30%
$1,000,001 to $10,000,000	193,443	549,528	96.79%	1.05%
$10,000,001 to $50,000,000	29,932	654,387	98.45%	1.94%
$50,000,001 to $100,000,000	7,290	519,178	98.86%	2.65%
More than $100,000,000	20,530	71,486,474	100.00%	100.00%
All Assets	1,797,278	73,431,840		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent Returns	Cumulative Percent Total Receipts
$0 or less	223,061	-15,496	12.41%	-0.07%
$1 to $2,500	46,820	49	15.02%	-0.07%
$2,501 to $5,000	29,231	113	16.64%	-0.07%
$5,001 to $10,000	42,501	317	19.01%	-0.07%
$10,001 to $25,000	98,843	1,671	24.51%	-0.06%
$25,001 to $50,000	108,038	3,996	30.52%	-0.04%
$50,001 to $100,000	154,729	11,337	39.13%	0.01%
$100,001 to $250,000	276,747	45,667	54.53%	0.23%
$250,001 to $500,000	212,272	77,224	66.34%	0.59%
$500,001 to $1,000,000	195,168	141,202	77.20%	1.26%
$1,000,001 to $10,000,000	337,815	1,020,309	95.99%	6.07%
$10,000,001 to $50,000,000	52,541	1,092,809	98.91%	11.22%
More than $50,000,000	19,510	18,843,110	100.00%	100.00%
All Receipts	1,797,278	21,222,309		

* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

Table A-11.– Distribution of S Corporations, 2008

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent: Returns	Cumulative Percent: Total Assets
$0 or less	722,118	0	17.83%	0.00%
$1 to $25,000	1,002,508	7,857	42.58%	0.23%
$25,001 to $50,000	415,105	14,177	52.83%	0.65%
$50,001 to $100,000	415,052	28,505	63.08%	1.50%
$100,001 to $250,000	568,719	90,348	77.12%	4.18%
$250,001 to $500,000	345,585	122,359	85.66%	7.81%
$500,001 to $1,000,000	239,203	167,535	91.56%	12.79%
$1,000,001 to $10,000,000	301,953	839,356	99.02%	37.72%
$10,000,001 to $50,000,000	32,765	644,961	99.83%	56.87%
$50,000,001 to $100,000,000	3,611	250,689	99.92%	64.31%
More than $100,000,000	3,326	1,201,517	100.00%	100.00%
All Assets	4,049,944	3,367,304		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent: Returns	Cumulative Percent: Total Receipts
$0 or less	552,003	-8,165	13.63%	-0.14%
$1 to $2,500	96,972	100	16.02%	-0.14%
$2,501 to $5,000	54,264	198	17.36%	-0.14%
$5,001 to $10,000	80,680	597	19.36%	-0.13%
$10,001 to $25,000	219,584	3,750	24.78%	-0.07%
$25,001 to $50,000	260,228	9,718	31.20%	0.09%
$50,001 to $100,000	400,774	29,242	41.10%	0.57%
$100,001 to $250,000	707,617	117,275	58.57%	2.51%
$250,001 to $500,000	536,784	191,812	71.83%	5.68%
$500,001 to $1,000,000	467,402	331,675	83.37%	11.17%
$1,000,001 to $10,000,000	585,763	1,637,854	97.83%	38.27%
$10,000,001 to $50,000,000	73,682	1,476,065	99.65%	62.69%
More than $50,000,000	14,192	2,253,935	100.00%	100.00%
All Receipts	4,049,944	6,044,056		

* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

Table A-12. –Distribution of Partnerships, 2008

Firms classified by assets	Number of Returns	Total Assets (millions)	Cumulative Percent: Returns	Cumulative Percent: Total Assets
$0 or less	831,112	-124,983	26.42%	-0.65%
$1 to $25,000	326,725	2,463	36.80%	-0.64%
$25,001 to $50,000	112,035	4,206	40.36%	-0.62%
$50,001 to $100,000	165,193	12,295	45.62%	-0.56%
$100,001 to $250,000	337,546	58,018	56.34%	-0.26%
$250,001 to $500,000	302,787	111,844	65.97%	0.32%
$500,001 to $1,000,000	293,703	210,331	75.31%	1.41%
$1,000,001 to $10,000,000	648,573	1,960,646	95.92%	11.59%
$10,000,001 to $50,000,000	95,883	1,972,643	98.97%	21.83%
$50,000,001 to $100,000,000	14,272	994,910	99.42%	27.00%
More than $100,000,000	18,180	14,057,430	100.00%	100.00%
All Assets	3,146,006	19,259,804		

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent: Returns	Cumulative Percent: Total Receipts
$0 or less	1,940,561	0	61.68%	0.00%
$1 to $2,500	88,435	89	64.49%	0.00%
$2,501 to $5,000	30,168	108	65.45%	0.00%
$5,001 to $10,000	56,704	418	67.26%	0.01%
$10,001 to $25,000	125,287	2,036	71.24%	0.06%
$25,001 to $50,000	97,436	3,661	74.34%	0.14%
$50,001 to $100,000	120,238	8,651	78.16%	0.34%
$100,001 to $250,000	206,257	34,255	84.71%	1.12%
$250,001 to $500,000	141,415	50,313	89.21%	2.26%
$500,001 to $1,000,000	118,379	83,280	92.97%	4.15%
$1,000,001 to $10,000,000	187,050	547,902	98.92%	16.61%
$10,000,001 to $50,000,000	26,111	540,309	99.75%	28.90%
More than $50,000,000	7,965	3,126,814	100.00%	100.00%
All Receipts	3,146,006	4,397,835		

* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

Table A-13.–Distribution of Nonfarm Sole Proprietorships, 2008

Firms classified by receipts	Number of Returns	Total Receipts (millions)	Cumulative Percent: Returns	Cumulative Percent: Total Receipts
$0 or less	1,151,951	0	5.09%	0.00%
$1 to $2,500	4,487,073	5,291	24.94%	0.41%
$2,501 to $5,000	2,457,593	8,913	35.80%	1.09%
$5,001 to $10,000	3,009,684	21,815	49.11%	2.77%
$10,001 to $25,000	4,522,767	72,407	69.11%	8.33%
$25,001 to $50,000	2,694,233	95,710	81.02%	15.68%
$50,001 to $100,000	1,903,231	133,731	89.44%	25.95%
$100,001 to $250,000	1,506,201	233,793	96.10%	43.91%
$250,001 to $500,000	519,138	179,845	98.40%	57.72%
$500,001 to $1,000,000	227,167	154,542	99.40%	69.59%
$1,000,001 to $10,000,000	132,164	273,398	99.99%	90.59%
$10,000,001 to $50,000,000	2,907	53,060	100.00%[1]	94.67%
More than $50,000,000	375	69,419	100.00%	100.00%
All Receipts	22,614,483	1,301,922		

* Details do not add to totals due to rounding.

[1] The actual figure is 99.9983 percent which rounds to 100.00 percent.

Source: JCT calculations on SOI data.

Table A-14a.–Distribution of Net Income by Gross Receipts and Entity Type, 2008

	Net Income (millions of dollars)		
Firms classified by receipts	S Corporations	Partnerships	Nonfarm Sole Proprietorships
$0 or less	-12,897	-132,165	-4,479
$1 to $2,500	-558	-703	-6,687
$2,501 to $5,000	-392	-280	-417
$5,001 to $10,000	-752	-917	6,311
$10,001 to $25,000	-1,541	-1,791	29,049
$25,001 to $50,000	-1,190	-2,309	33,783
$50,001 to $100,000	1,641	-2,088	43,637
$100,001 to $250,000	9,874	-888	65,726
$250,001 to $500,000	13,076	-67	40,290
$500,001 to $1,000,000	20,007	1,770	27,883
$1,000,001 to $10,000,000	83,359	25,270	26,740
$10,000,001 to $50,000,000	54,503	18,052	2,166
More than $50,000,000	74,896	206,921	505
All Receipts	240,026	110,806	264,508

Table A-14b.–Percent of Firms with a Net Operating Loss by Gross Receipts and Entity Type, 2008

Firms classified by receipts	S Corporations	Partnerships	Nonfarm Sole Proprietorships
$0 or less	58	27	83
$1 to $2,500	77	70	40
$2,501 to $5,000	69	56	30
$5,001 to $10,000	58	65	22
$10,001 to $25,000	52	54	15
$25,001 to $50,000	45	49	13
$50,001 to $100,000	34	41	12
$100,001 to $250,000	30	39	12
$250,001 to $500,000	31	37	12
$500,001 to $1,000,000	28	39	12
$1,000,001 to $10,000,000	26	33	18
$10,000,001 to $50,000,000	26	33	34
More than $50,000,000	21	28	59
All Receipts	38	34	25

* Details do not add to totals due to rounding.

Source: JCT calculations on SOI data.

Table A-15a.–Distribution of Net Income by Gross Receipts of C Corporations, 2008

Firms classified by receipts	Net Income (millions of dollars)
$0 or less	-72,237
$1 to $2,500	-956
$2,501 to $5,000	-483
$5,001 to $10,000	-789
$10,001 to $25,000	-1,577
$25,001 to $50,000	-1,830
$50,001 to $100,000	-2,502
$100,001 to $250,000	-4,500
$250,001 to $500,000	-3,848
$500,001 to $1,000,000	-3,985
$1,000,001 to $10,000,000	-8,585
$10,000,001 to $50,000,000	26,220
More than $50,000,000	819,389
All Receipts	744,316

Table A-15b.–Percent of C Corporations with a Net Operating Loss by Gross Receipts, 2008

Firms classified by receipts	C Corporations
$0 or less	71
$1 to $2,500	67
$2,501 to $5,000	60
$5,001 to $10,000	54
$10,001 to $25,000	56
$25,001 to $50,000	52
$50,001 to $100,000	51
$100,001 to $250,000	46
$250,001 to $500,000	46
$500,001 to $1,000,000	42
$1,000,001 to $10,000,000	35
$10,000,001 to $50,000,000	31
More than $50,000,000	32
All Receipts	48

* Details do not add to totals due to rounding.
Source: JCT calculations on SOI data.

D. Corporate Income Tax Supplement - General Business Credits

The general business credit is the sum of various business credits determined under the Code. The component credits of the general business credit are listed below.

The general business credit may not reduce a taxpayer's net income tax below an amount equal to the taxpayer's tentative minimum tax (or, if greater, 25 percent of so much of the taxpayer's regular tax liability as exceeds $25,000). For purposes of applying this rule to certain credits (the alcohol fuels credit, the low-income housing credit, portions of the renewable electricity production credit, the employer Social Security credit, the railroad track maintenance credit, the small employer health insurance credit, the energy credit, the rehabilitation credit, and work opportunity credit), the tentative minimum tax is treated as being zero.

General business credits determined in a taxable year that exceed the amount allowable in that year generally may be carried back one year and forward up to 20 years. Credits for small businesses determined in 2010 were allowed a five-year carryback.

Table A-16.–Components of the General Business Credit for 2011*

Provision	Description
Rehabilitation credit (sec. 47)	Credit for restoring certain pre-1936 buildings and certain historic buildings
Energy credit (sec. 48)	Credit for investing in certain solar, geothermal, fuel cell, and other energy property
Advanced coal project credit (sec. 48A)	Credit for investing in advanced coal power facilities
Gasification project credit (sec. 48B)	Credit for investing in gasification facilities
Advanced energy project credit (sec. 48C)	Credit for investing in facilities that manufacture certain renewable power or other advanced energy equipment or products
Work opportunity credit (sec. 51)	Credit for hiring employees from certain targeted groups
Alcohol fuels credit (sec. 40)	Credit for producing ethanol and other alcohol fuels
Research credit (sec. 41)	Credit for conducting research in the United States
Low-income housing credit (sec. 42)	Credit for owners of qualified low-income rental housing
Disabled access credit (sec. 44)	Credit to offset costs incurred by small businesses to comply with the Americans With Disabilities Act of 1990
Renewable electricity production credit (sec. 45)	Credit for producing power from wind, biomass, and other renewable resources
Empowerment zone employment credit (sec. 1396)	Credit for employing people in certain designated areas with high levels of unemployment and poverty
Indian employment credit (sec. 45A)	Credit for employing native Americans living and working on Indian reservations

Table A-16.–Components of the General Business Credit for 2011*	
Provision	**Description**
Employer Social Security credit (sec. 45B)	Credit for an employer's portion of Social Security taxes paid on employee cash tips in excess of the minimum wage
Orphan drug credit (sec. 45C)	Credit for clinical testing of drugs used to treat certain rare diseases or conditions
New markets tax credit (sec. 45D)	Credit for investing in community development entities, which serve low income communities
Small employer pension plan startup cost credit (45E)	Credit for small employers that start qualified pension plans
Employer-provided child care credit (sec. 45F)	Credit for building or running an employer-provided child care facility
Railroad track maintenance credit (sec.45G)	Credit for railroad track maintenance expenses
Biodiesel fuels credit (sec. 40A)	Credit for producing biodiesel
Distilled spirits credit (sec. 5011)	Credit to wholesalers, distillers, and importers of distilled spirits that approximates the interest cost resulting from the early imposition of certain excise taxes
Advanced nuclear power production credit (sec. 45J)	Credit for producing nuclear power at advanced nuclear power facilities
New energy efficient homes credit (sec. 45L)	Credit for building energy efficient homes
Energy efficient appliance credit (sec. 45M)	Credit for manufacturing energy efficient appliances
Alternative fuel refueling property credit (sec. 30C)	Credit for installing certain biofuel, electric, and alternative fuel refueling property
Mine rescue team training credit (sec. 45N)	Credit for training mine rescue team employees
Agricultural chemicals security credit (sec. 45O)	Credit for conducting backgrounds checks, installing security devices, and taking other measures to safeguard certain fertilizers and pesticides used on farms
Differential wage payment credit (sec. 45P)	Credit for small employers who supplement the military pay of their employees called to active duty
Carbon dioxide sequestration credit (sec. 45Q)	Credit for sequestering industrial source carbon dioxide
Alternative motor vehicle credit (sec. 30B)	Credit for fuel cell vehicles and hybrid vehicle conversions
Plug-in electric drive motor vehicle credit (secs. 30 and 30D)	Credit for plug-in electric drive motor vehicles
Small employer health insurance credit (sec. 45R)	Credit for small employers who provide health insurance to their employees

* Excludes expired and phased-out credits.

E. New Tax Expenditures since the Tax Reform Act of 1986

The Tax Reform Act of 1986[80] "represents one of the most comprehensive revisions of the Federal income tax system since its inception."[81] Among other considerations, Congress was concerned that erosion of the tax base required tax rates to be higher than otherwise would be necessary. With the elimination of various tax expenditures and other preferences and the enactment of other base-broadening provisions, the Act sharply reduced individual income tax rates. The Act retained some of the tax expenditures most widely utilized by individuals and business tax expenditures believed to be beneficial to the economy.

Numerous changes to the Code have been enacted in subsequent tax legislation. The information that follows provides a list of the new tax expenditures contained in legislation since the passage of the Tax Reform Act of 1986.[82] Modifications and extensions of pre-existing tax expenditures are not listed. Items are grouped by the legislation by which they were created. Items that have since expired are shown in italics.

Technical and Miscellaneous Revenue Act of 1988, enacted on November 10, 1988 (Pub. L. No. 100-647).

- Exclusion of income from United States savings bonds used to pay higher education tuition and fees

Omnibus Budget Reconciliation Act of 1990, enacted on November 5, 1990 (Pub. L. No. 101-508).

- Enhanced oil recovery credit
- Credit for small producers of ethanol
- Credit for cost of providing access for disabled individuals
- *Credit for health insurance costs for coverage of children*
- Reduced rate of tax on capital gains (effective with increase in individual income tax rates)

---

[80] Pub. L. No. 99-514.

[81] Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87), May 4, 1987, p. 6.

[82] This list may not be exhaustive. Differences in the methodology for (1) identifying tax expenditures (including negative tax expenditures) generally, (2) determining what constitutes a new provision versus a modification or extension of an existing provision, and (3) determining whether a provision is *de minimis* may yield a different list of provisions.

Omnibus Budget Reconciliation Act of 1993, enacted on August 10, 1993 (Pub. L. No. 103-66).

- Exclusion for gain from certain small business stock
- Rollover of gain from sale of publicly traded securities into specialized small business investment companies
- *Tax incentives for businesses in empowerment zones, enterprise communities, and rural development investment areas*
- Accelerated depreciation for property on Indian reservations
- Indian employment credit
- Modification of passive loss rules for certain real estate professionals
- Modification of unrelated business taxable income rules relating to real estate
- Exclusion of income from discharge of indebtedness incurred in connection with qualified real property
- Credit for portion of employer paid FICA taxes on tips

Small Business Job Protection Act of 1996, enacted on August 20, 1996 (Pub. L. No. 104-188).

- Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters
- Exclusion of contributions in aid of construction for water and sewer utilities
- Adoption tax credit
- Exclusion of employer adoption assistance programs
- Deferral of tax on earnings of qualified State tuition programs
- Tax-free transfer of assets from common trust funds to mutual funds

Health Insurance Portability and Accountability Act of 1996, enacted on August 21, 1996 (Pub. L. No. 104-191).

- Medical savings accounts

Taxpayer Relief Act of 1997, enacted on August 5, 1997 (Pub. L. No. 105-34).

- Tax credit for taxpayers with qualifying children under the age of 17
- HOPE and Lifetime Learning credits for tuition for post-secondary education
- Exclusion of earnings of trust or custodial accounts for paying higher education expenses
- Deduction for interest on qualified higher education loans

- *Credit for holders of qualified zone academy bonds*
- Tax incentives for D.C. Enterprise Zones
- D.C. first-time homebuyer tax credit
- Welfare-to-work tax credit
- Income averaging for farmers
- Expensing of environmental remediation expenditures
- *Tax refund to Amtrak based on the carryback of its net operating losses against the tax attributes of its predecessor railroads*
- Exclusion for certain disaster mitigation payments
- Exclusion of survivor annuities paid to families of public safety officers killed in the line of duty

<u>Tax and Trade Relief Extension Act of 1998, as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (Pub. L. No. 105-277).</u>

- Special five-year carryback period for net operating losses attributable to farming

<u>FSC Repeal and Extraterritorial Income Exclusion Act of 2000, enacted on November 15, 2000 (Pub. L. No. 106-519).</u>

- *Extraterritorial income exclusion*

<u>Community Renewal Tax Relief Act of 2000, incorporated by reference in the Consolidated Appropriations Act, 2001, enacted on December 2, 2000 (Pub. L. No. 106-554).</u>

- *Renewal community tax incentives*
- New markets tax credit

<u>Economic Growth and Tax Relief Reconciliation Act of 2001, enacted on June 7, 2001 (Pub. L. No. 107-16).</u>

- Deduction for qualified higher education expenses
- Tax credit for employers who provide child care for employees
- Exclusion for certain restitution payments made to individuals who were persecuted for racial or religious reasons by Nazi Germany or other Axis regimes
- Credit for certain individuals for elective deferrals and IRA contributions
- Nonrefundable credit for administrative and retirement-education expenses for new pension plans adopted by small businesses
- Treatment of electing Alaska Native Settlement Trusts

Job Creation and Worker Assistance Act of 2002, enacted on March 9, 2002 (Pub. L. No. 107-147).

- Additional first-year depreciation deduction for qualified property to which the general rules of MACRS apply
- Above the line deduction for teacher classroom expenses
- Additional first-year depreciation deduction for qualified New York Liberty Zone property
- Authority to issue $8 billion of tax-exempt private activity bonds to finance the construction and rehabilitation of nonresidential real property and residential rental real property in the New York Liberty Zone
- Authority for one additional advance refunding for certain bonds for facilities located in New York City
- A five-year recovery period was provided for qualified New York Liberty Zone leasehold improvement property

Trade Act of 2002, enacted on August 6, 2002 (Pub. L. No. 107-210).

- Tax credit for the purchase of health insurance coverage by certain taxpayers

Jobs and Growth Tax Relief Reconciliation Act of 2003, enacted on May 28, 2003 (Pub. L. No. 108-27).

- Reduced rates of tax on qualified dividends

Military Family Tax Relief Act of 2003, enacted on November 11, 2003 (Pub. L. No. 108-121).

- Exclusion for amounts received under Department of Defense Homeowners Assistance Program
- Deduction for overnight travel expenses of National Guard and Reserve members

Medicare Prescription Drug, Improvement, and Modernization Act of 2003, enacted on December 8, 2003 (Pub. L. No. 108-173).

- Exclusion of untaxed Medicare benefits: Prescription drug insurance (Part D)
- Exclusion of subsidies to employers who maintain prescription drug plans for Medicare retirees
- Health savings accounts

American Jobs Creation Act of 2004, enacted on October 22, 2004 (Pub. L. No. 108-357).

- Production activity deduction

- Deduction of film and television production costs
- Tax credit for expenditures for maintaining railroad tracks
- Elective "tonnage tax" in lieu of corporate income tax on taxable income from certain shipping activities
- Tax credit for biodiesel blenders
- Charitable deduction for certain expenses incurred in carrying out sanctioned whaling activities
- Incentives for small refiners to comply with EPA sulfur regulations
- Exclusion of interest on State and local government bonds for qualified green building and sustainable design projects
- Deferral of gain from the disposition of electric transmission property to implement Federal Energy Regulatory Commission restructuring policy

H.R. 241, enacted on January 7, 2005 (Pub. L. No. 109-1).

- Accelerated deduction for cash contributions for Indian Ocean tsunami victims

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, enacted on August 10, 2005 (Pub. L. No. 109-59).

- Tax credit for the cost of carrying tax-paid distilled spirits in wholesale inventories
- Exclusion of interest on State and local government qualified private activity bonds for highway projects and rail-truck transfer facilities

Energy Tax Incentives Act of 2005, enacted on August 8, 2005 (Pub. L. No. 109-58).

- Tax credit for the holders of clean renewable energy bonds
- Tax credit for the production of electricity from qualifying advanced nuclear power facilities
- Tax credits for investments in clean coal power generation facilities
- Temporary election for refiners to expense up to 50 percent of the cost of qualified property used in the refining of liquid fuels
- Two-year amortization for certain geological and geophysical costs incurred in connection with oil and gas exploration
- Deduction for expenditures on qualified energy-efficient commercial building property
- Tax credit for the purchase of qualified energy efficiency improvements to existing homes
- Tax credit for the production of certain energy-efficient appliances

- Tax credit for the purchase of qualified photovoltaic property and qualified solar water heating property used exclusively for purposes other than heating swimming pools and hot tubs
- Tax credit for eligible contractors for the construction of qualified energy-efficient homes
- Tax credits for alternative technology vehicles
- Tax credit for the cost of installing clean-fuel vehicle refueling property
- Temporary five-year carryback period for a portion of the net operating losses of certain electric utility companies
- Tax credits for biodiesel fuels

The Katrina Emergency Tax Relief Act of 2005, enacted on September 23, 2005 (Pub. L. No. 109-73).

- Tax credit for employee retention for employers affected by Hurricanes Katrina, Rita, and Wilma
- Additional personal exemption for taxpayers who provide 60 days or more of free housing in their personal residence to individuals displaced by Hurricane Katrina
- Exclusion for the income from certain discharges of nonbusiness debt owed by individuals harmed by Hurricane Katrina

The Gulf Opportunity Zone Act of 2005, enacted on December 21, 2005 (Pub. L. No. 109-135).

- Additional first-year depreciation deduction for qualified Gulf Opportunity Zone property
- Partial expensing for Gulf Opportunity Zone clean-up costs
- Ten-year carryback period for casualty losses of Gulf Opportunity Zone public utility property by reason of Hurricane Katrina
- Five-year carryback period for net operating losses attributable to expenses
- Tax credit for the holders of Gulf Tax Credit Bonds
- Five-year carryback period for casualty losses of public utility property attributable to Hurricane Katrina
- Tax credit for Gulf Opportunity Zone employers providing in-kind lodging for employees and income exclusion for the employees

Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006 (Pub. L. No. 109-222).

- Exclusion for earnings of certain environmental settlement funds

- Reduced rates of tax for gains from the sale or exchange of self-created musical works
- Elective five-year amortization of expenses paid or incurred for the creation or acquisition of musical compositions

The Tax Relief and Health Care Act of 2006, enacted on December 20, 2006 (Pub. L. No. 109-432).

- Tax credit for corporate income earned in American Samoa
- Special depreciation allowance for cellulosic biomass ethanol plant property
- Partial expensing for investments in advanced mine safety equipment
- Credit for costs incurred in training qualified mine rescue team employees
- Deduction for premiums paid or accrued for qualified mortgage insurance
- 25-percent exclusion from gross income for capital gains from the conservation sale of a qualifying mineral or geothermal interest located on eligible Federal land

Hokie Spirit Memorial Fund, enacted December 19, 2007 (Pub. L. No. 110-141).

- Exclusion of amounts received from the Hokie Spirit Memorial Fund, established by the Virginia Tech Foundation

Mortgage Forgiveness Debt Relief Act of 2007, enacted December 20, 2007 (Pub. L. No. 110-142).

- Exclusion of indebtedness income arising from discharge of qualified principal residence indebtedness
- Exclusion of benefits provided to volunteer firefighters and emergency medical responders

Economic Stimulus Act of 2008, enacted February 13, 2008 (Pub. L. No. 110-185)

- Recovery rebates for individual taxpayers
- Additional first year depreciation deduction for qualified property

Food, Conservation, and Energy Act of 2008, enacted May 22, 2008 (Pub. L. No. 110-234 and 110-246).

- Exclusion of Conservation Reserve Program payments from SECA tax for individuals receiving Social Security retirement or disability payments
- Deduction for endangered species recovery expenditures
- Credit for cellulosic biofuel
- Tax credit bonds for qualified forestry conservation projects

- Agricultural chemicals security tax credit

Heroes Earnings Assistance and Relief Tax Act of 2008, enacted June 17, 2008 (Pub. L. No. 110-245).

- Employer wage credit for activated military reservists
- Exclusion of certain State and local payments to military personnel

Housing and Economic Recovery Act of 2008, enacted July 30, 2008 (Pub. L. No. 110-289).

- First time homebuyer credit
- Additional standard deduction for State and local real property taxes
- Bonds guaranteed by Federal Home Loan Banks eligible for treatment as tax-exempt bonds

Emergency Economic Stabilization Act of 2008, Energy Improvement and Extension Act of 2008, and Tax Extenders and Alternative Minimum Tax Relief Act of 2008, enacted October 3, 2008 (Pub. L. No. 110-343).

- New clean renewable energy bonds
- Credit for carbon dioxide sequestration
- Alternative motor vehicle credit and plug in electric vehicle credit
- Qualified energy conservation bonds
- Accelerated recovery period for depreciation of smart meters and smart grid system
- Special depreciation allowance for certain reuse and recycling property
- Treatment of amounts received in connection with the Exxon Valdez litigation.
- Tax exempt bond financing for the Midwestern Disaster Area
- Expensing for certain demolition and clean up costs
- Tax credit bonds
- Additional personal exemption for housing displaced individuals in the Midwestern Disaster area
- Mileage reimbursements to charitable volunteers excluded from gross income
- Exclusions for certain cancellations of indebtedness by reason of Midwestern disasters
- Expensing of qualified disaster expenses
- Special depreciation allowance for qualified disaster property
- Increased expensing for qualified disaster assistance property

The American Recovery and Reinvestment Act of 2009, enacted on February 17, 2009 (Pub. L. No. 111-5).

- Making work pay credit
- Exclusion from gross income for up to $2,400 of unemployment compensation
- Deduction for any State or local sales or excise tax imposed on the purchase of a new car, light truck, motorcycle, or motor home
- Election to receive an investment credit in lieu of a renewable electricity production credit
- Credit for alternative motor vehicles
- Deferral of income arising from business indebtedness discharged by the reacquisition of a debt instrument
- Credit for investment in advanced energy property
- Issuance of recovery zone economic development bonds and recovery zone facility bonds
- Tribal economic development bonds
- Suspension of classification of tax-exempt interest on certain bonds as a tax preference for AMT purposes
- Qualified school construction bonds
- Build America bonds
- Credit against income taxes owed for tax year 2009 for individuals who receive a government pension or annuity from work not covered by social security
- Premium subsidy for COBRA continuation coverage for unemployed workers and their families

Hiring Incentives to Restore Employment Act, enacted on March 18, 2010 (Pub. L. No. 111-147).

- Credit for retention of certain newly hired workers

Patient Protection and Affordable Care Act, enacted March 23, 2010 (Pub. L. No. 111-148), in combination with the Health Care and Education Reconciliation Act of 2010, enacted March 30, 2010 (Pub. L. No. 111-152).

- Credits and subsidies for participation in exchanges
- Tax credit for small businesses purchasing employer insurance
- Annual fees imposed on any covered entity engaged in the business of providing health insurance with respect to United States health risks are not deductible as ordinary and necessary business expenses

- Limits on deductible compensation for insurance companies
- Exclusion of Indian health care benefits
- *Therapeutic research credit*
- Surtax on unearned income

The Small Business Jobs Act of 2010, enacted on September 27, 2010 (Pub. L. No. 111-240).

- Extended carryback period for eligible small business credits from one year to five years

F. Historical Trends in the Largest Tax Expenditures, Individual and Corporate

Individual Tax Expenditures

The tables below illustrate in five-year segments the top ten largest tax expenditures for individuals since 1975.

Table A-17.–Largest Tax Expenditures, Individual 1975-1979

Tax Expenditure	Total Amount (1975-1979) (Billions of dollars)
Exclusion of capital gains at death	37.6
Deduction for nonbusiness State and local taxes (other than State and local property taxes on owner-occupied homes)	37.3
Net exclusion of pension contributions and earnings: employer plans	32.4
Capital gain (other than farming and timber)	32.0
Deduction for mortgage interest on owner-occupied homes	25.7
Exclusion of employer contributions to medical insurance premiums and medical care	21.2
Deduction for State and local property taxes on owner-occupied homes	21.0
Exclusion of untaxed social security and railroad retirement benefits	17.7
Deduction for charitable contributions, other than for education and health	16.9
Exclusion of unemployment insurance benefits	13.6

Table A-18.–Largest Tax Expenditures, Individual 1980-1984

Tax Expenditure	Total Amount (1980-1984) (Billions of dollars)
Deduction for nonbusiness State and local taxes (other than State and local property taxes on owner-occupied homes)	104.9
Exclusion of employer contributions to medical insurance premiums and medical care	91.5
Deduction for mortgage interest on owner-occupied homes	89.5
Net exclusion of pension contributions and earnings: employer plans	85.5
Capital gains (other than farming and timber)	80.4
Deduction for State and local property taxes on owner-occupied homes	53.2
Exclusion of untaxed social security and railroad retirement benefits	53.1
Deduction for charitable contributions, other than for education and health	39.4
Deduction for medical expenses	23.2
Exclusion of interest on life insurance savings	23.0

Table A-19.--Largest Tax Expenditures, Individual 1985-1989

Tax Expenditure	Total Amount (1985-1989) (Billions of dollars)
Net exclusion of pension contributions and earnings: employer plans	334.6
Deduction for nonbusiness State and local taxes (other than State and local property taxes on owner-occupied homes)	143.5
Exclusion of employer contributions to medical insurance premiums and medical care	133.4
Capital gains, other than agricultural, timber, iron ore and coal	111.0
Deduction for mortgage interest on owner-occupied homes	75.6
Exclusion of untaxed social security and railroad retirement benefits	71.6
Deduction for charitable contributions, other than for education and health	62.4
Deduction for State and local property tax on owner-occupied homes	61.7
Individual retirement plans	59.3
Deduction for nonmortgage interest in excess of investment income	41.1

Table A-20.–Largest Tax Expenditures, Individual 1990-1994

Tax Expenditure	Total Amount (1990-1994) (Billions of dollars)
Net exclusion of pension contributions and earnings: employer plans	272.9
Exclusions of contributions by employers for medical insurance premiums and medical care	205.5
Deduction for mortgage interest on owner-occupied homes	133.5
Exclusion of untaxed social security and railroad retirement benefits	127.2
Deduction of nonbusiness State and local government income and personal property taxes (other than State and local property taxes on owner-occupied homes)	109.4
Deferral of capital gains on sales of principal residences	57.4
Deduction for charitable contributions, other than for education and health	55.8
Exclusion of interest on general purpose State and local government debts	54.1
Individual retirement plans	52.5
Deduction for State and local property tax on owner-occupied homes	43.5

Table A-21.–Largest Tax Expenditures, Individual 1995-1999

Tax Expenditure	Total Amount (1995-1999) (Billions of dollars)
Net exclusion of pension contributions and earnings: employer plans	391.6
Deduction for mortgage interest on owner-occupied homes	302.1
Exclusion of employer contributions for medical insurance premiums and medical care	269.7
Deduction of nonbusiness State and local government income and personal property taxes (other than State and local property taxes on owner-occupied homes)	139.0
Exclusion of untaxed social security and railroad retirement benefits	125.5
Deferral of capital gains on sales of principal residences	79.4
Exclusion of capital gains at death	77.5
Deduction for charitable contributions, other than for education and health	77.0
Deduction for State and local property tax on owner-occupied homes	76.8
Exclusion on investment income on life insurance and annuity contracts	61.8

Table A-22.–Largest Tax Expenditures, Individual 2000-2004

Tax Expenditure	Total Amount (2000-2004) (Billions of dollars)
Net exclusion of pension contributions and earnings: employer plans	416.0
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	324.1
Deduction for mortgage interest on owner-occupied homes	301.4
Reduced rates of tax on long-term capital gains	194.6
Deduction of nonbusiness State and local government income and personal property taxes (other than State and local property taxes on owner-occupied homes)	190.0
Exclusion of capital gains at death	136.1
Exclusion of untaxed social security and railroad retirement benefits	131.9
Deduction of charitable contributions, other than for education and health	124.3
Exclusion of investment income on life insurance and annuity contracts	121.8
Deduction for State and local property taxes on owner-occupied residences	101.3

Table A-23.–Largest Tax Expenditures, Individual 2005-2009

Tax Expenditure	Total Amount (2005-2009) (Billions of dollars)
Net exclusion of pension contributions and earnings: employer plans	567.8
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	493.7
Deduction for mortgage interest on owner-occupied homes	434.2
Reduced rates of tax on dividends and long-term capital gains	356.8
Tax credit for children under age 17	231.7
Exclusions of capital gains at death	215.6
Earned income credit	195.1
Deduction of nonbusiness State and local government income, sales and personal property taxes	185.8
Deductions for charitable contributions, other than for education and health	159.2
Exclusion of benefits provided under cafeteria plans	134.4

Table A-24.–Largest Tax Expenditures, Individual 2010-2014

Tax Expenditure	Total Amount (2010-2014) (Billions of dollars)
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	659.4
Deduction for mortgage interest on owner-occupied homes	484.1
Reduced rates of tax on dividends and long-term capital gains	402.9
Net exclusion of pension contributions and earnings: Defined benefit plans	303.2
Earned income credit	268.8
Deduction of nonbusiness State and local government income, sales and personal property taxes	237.3
Net exclusion of pension contributions and earnings: Defined contribution plans	212.2
Exclusions of capital gains at death	194.0
Deductions for charitable contributions, other than for education and health	182.4
Exclusion of untaxed social security and railroad retirement benefits	173.0

Corporate Tax Expenditures

The tables below illustrate in five-year segments the top ten largest corporate tax expenditures since 1975.

Table A-25.–Largest Tax Expenditures, Corporate 1975-1979

Tax Expenditure	Total Amount (1975-1979) (Billions of dollars)
Investment Credit	29.0
Corporate surtax exemption	22.0
Exclusion of interest on general purpose State and local debt	15.7
Asset depreciation range	8.2
Deferral of income of domestic international sales corporations	6.8
Excess of percentage over cost depletion	6.2
Expensing of construction period interest and taxes	5.3
Capital gain: corporate (other than farming and timber)	4.5
Financial institutions: excess bad debt reserves	3.6
Expensing of research and development expenditures	3.5

Table A-26.–Largest Tax Expenditures, Corporate 1980-1984

Tax Expenditure	Total Amount (1980-1984) (Billions of dollars)
Investment Credit, other than for TRASOPs and for rehabilitated structures	89.4
Reduced rates on first $100,000 of corporate taxable income	41.6
Exclusion of interest on general purpose State and local debt	21.9
Asset depreciation range	18.9
Exclusion of interest on State and local housing bonds	12.0
Expensing of research and development expenditures	11.3
Expensing of exploration and development costs	9.6
Deferral of income of domestic international sales corporations	8.0
Excess of percentage over cost depletion	7.5
Excess bad debt reserves of financial institutions	5.2

Table A-27.–Largest Tax Expenditures, Corporate 1985-1989

Tax Expenditure	Total Amount (1985-1989) (Billions of dollars)
Investment Credit, other than for ESOPs, rehabilitation of structures, reforestation, leasing and energy property	176.0
Accelerated depreciation on equipment other than leased property	79.9
Exclusion of interest on general purpose State and local debt	54.4
Reduced rates on first $100,000 of corporate taxable income	45.6
Exclusion of interest on State and local government industrial development bonds	19.1
Expensing of research and development expenditures	16.3
Capital gains, other than agricultural, timber, iron ore and coal	15.0
Tax credit for ESOPs	12.2
Exclusion of possessions source income	8.8
Expensing of exploration and development costs: oil and gas	8.0

Table A-28.–Largest Tax Expenditures, Corporate 1990-1994

Tax Expenditure	Total Amount (1990-1994) (Billions of dollars)
Depreciation of equipment in excess of alternative depreciation system	70.9
Reduced rates on first $75,000 of corporate taxable income	28.6
Inventory property sales source rule exception	15.9
Merger rules for banks and thrift institutions	11.7
Exclusion and tax credit for corporations with possessions source income	11.5
Deduction of unpaid loss reserves for property and casualty insurance companies	8.2
Expensing of research and development expenditures	8.1
Investment credit other than ESOPs, rehabilitation of structures, reforestation and energy property	7.1
Exclusion of interest on general purpose State and local government debt	6.6
Exclusion of income of foreign sales corporations	4.3

Table A-29.–Largest Tax Expenditures, Corporate 1995-1999

Tax Expenditure	Total Amount (1995-1999) (Billions of dollars)
Depreciation of equipment in excess of alternative depreciation system	97.7
Reduced rates for first $10,000,000 of corporate taxable income	21.7
Tax credit for section 936 income	19.7
Inventory property sales source rule exception	18.3
Exclusion of interest on general purpose State and local government debt	17.5
Depreciation on buildings other than rental housing in excess of alternative depreciation system	13.0
Special treatment of life insurance company reserves	12.5
Deduction of unpaid property loss reserves for property and casualty insurance companies	9.7
Exclusion of income of foreign sales corporations	7.5
Deferral of income of controlled foreign corporations	5.7

Table A-30.–Largest Tax Expenditures, Corporate, 2000-2004

Tax Expenditure	Total Amount (2000-2004) (Billions of dollars)
Depreciation of equipment in excess of alternative depreciation system	119.0
Exclusion of interest on public purpose State and local government debt	27.2
Reduced rates for first $10,000,000 of corporate taxable income	22.0
Inventory property sales source rule exception	22.0
Deferral of active income of controlled foreign corporations	19.8
Tax credit for Puerto Rico and possession income, and Puerto Rico economic activity	17.6
Tax credit for qualified research expenditures	17.3
Exclusion of income of foreign sales corporations	15.6
Expensing of research and experimental expenditures	14.9
Deduction for unpaid property loss reserves for property and casualty insurance companies	14.7

Table A-31.–Largest Tax Expenditures, Corporate 2005-2009

Tax Expenditure	Total Amount (2005-2009) (Billions of dollars)
Depreciation of equipment in excess of alternative depreciation system	71.3
Exclusion of interest on public purpose State and local government debt	38.3
Inventory property sales source rule exception	30.9
Expensing of research and experimental expenditures	28.5
Deferral of active income of controlled foreign corporations	25.8
Reduced rates for first $10,000,000 of corporate taxable income	23.7
Deduction for income attributable to domestic production activities	19.8
Tax credit for low-income housing	17.5
Exclusion of investment income on life insurance and annuity contracts	12.8
Tax credit for qualified research expenditures	10.7

Table A-32.–Largest Tax Expenditures, Corporate 2010-2014

Tax Expenditure	Total Amount (2010-2014) (Billions of dollars)
Deferral of active income of controlled foreign corporations	70.6
Exclusion of interest on public purpose State and local government debt	45.3
Deduction for income attributable to domestic production activities	43.2
Inventory property sales source rule exception	38.0
Depreciation of equipment in excess of alternative depreciation system	37.1
Inclusion of income arising from business indebtedness discharged by the reacquisition of a debt instrument	28.8
Tax credit for low-income housing	27.0
Expensing of research and experimental expenditures	25.6
Inventory methods and valuation: Last in first out	20.0
Reduced rates for first $10,000,000 of corporate taxable income	15.9

Congress of the United States
JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
http://www.jct.gov

SEP 28 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This is in response to separate questions raised by Co-Chariman Hensarling and Congressman Clyburn regarding the distribution of income and employment taxes at the September 22, 2011, hearing of the Joint Select Committee on Deficit Reduction.

Table 1 shows the estimated distribution of combined Federal income, employment, and excise taxes by income category, for 2011. Table 1 also separately shows the estimated distribution of individual income taxes and the estimated distribution of employment taxes. Table 1 also reports average combined Federal tax rates by income category, as well as average income tax rates and average employment tax rates by income category. As Table 1 shows, individual income taxes are more concentrated at the top of the income distribution, while employment taxes are more evenly spread through the income distribution, though with a decline at the very top of the distribution.

Table 2 shows the estimated distribution of selected sources of income for 2011. As the table shows, certain sources of income, such as capital gain, dividend, and Schedule E (partnership, S-corporation, and other pass-throughs) income are relatively more concentrated at the top of the income distribution.

Lastly, Table 3 shows, for 2011, the estimated distribution of returns that have employment taxes (including the employer share of these taxes) in excess of income Because of the progressive income tax structure and the generally flat structure of employment taxes, the likelihood employment taxes will exceed income taxes increases as income levels decline. Thus, for example, in the $40,000 to $50,000 income group, 80.5 percent of tax returns have employment taxes greater than income taxes, while in the $100,000 to $200,000 group 55.2 percent of returns have employment taxes greater than income taxes. Overall, for 2011, 75.4 percent of returns are estimated to have employment taxes in excess of income taxes.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Senator Murray and Mr. Hensarling:
Joint Select Committee on Deficit Reduction

I hope this information is helpful. If you have further questions related to these materials, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

Enclosures

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Table 1.–Distribution of Income and Taxes, and Average Tax Rates in 2011

INCOME CATEGORY (1)	Number of Returns (2) (Thousands)	Share of Returns	Income (Millions of Dollars)	Share of Income	COMBINED INCOME, SOCIAL INSURANCE, AND EXCISE TAXES UNDER PRESENT LAW (3)			INDIVIDUAL INCOME TAXES			EMPLOYMENT TAXES		
					$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate
Less than $10,000	20,429	13.1%	83,306	0.8%	4.4	0.2%	5.3%	-8.7	-0.9%	-10.4%	8.3	1.1%	10.0%
$10,000 to $20,000	16,910	10.8%	258,398	2.4%	1.6	0.1%	0.6%	-24.1	-2.5%	-9.3%	21.3	2.7%	8.3%
$20,000 to $30,000	18,400	11.8%	457,489	4.2%	23.9	1.3%	5.2%	-13.5	-1.4%	-2.9%	31.7	4.0%	6.9%
$30,000 to $40,000	15,387	9.8%	538,090	5.0%	46.2	2.5%	8.6%	0.3	0.0%	0.1%	40.2	5.1%	7.5%
$40,000 to $50,000	13,602	8.7%	610,307	5.7%	64.3	3.5%	10.5%	13.3	1.4%	2.2%	45.4	5.8%	7.4%
$50,000 to $75,000	26,719	17.1%	1,650,379	15.3%	212.1	11.7%	12.8%	73.6	7.8%	4.5%	125.4	15.9%	7.6%
$75,000 to $100,000	16,955	10.8%	1,466,089	13.6%	218.6	12.1%	14.9%	91.8	9.7%	6.3%	116.8	14.8%	8.0%
$100,000 to $200,000	22,128	14.1%	2,967,912	27.6%	574.1	31.7%	19.3%	282.8	29.8%	9.5%	274.2	34.8%	9.2%
$200,000 to $500,000	4,945	3.2%	1,355,166	12.6%	327.2	18.1%	24.1%	224.9	23.7%	16.6%	96.8	12.3%	7.1%
$500,000 to $1,000,000	631	0.4%	423,207	3.9%	113.3	6.2%	26.8%	95.9	10.1%	22.6%	16.0	2.0%	3.8%
$1,000,000 and over	330	0.2%	960,890	8.9%	226.9	12.5%	23.6%	213.3	22.5%	22.2%	12.8	1.6%	1.3%
Total, All Taxpayers	156,435	100.0%	10,771,229	100.0%	1,812.4	100.0%	16.8%	949.6	100.0%	8.8%	789.0	100.0%	7.3%

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

Source: Staff of the Joint Committee on Taxation.

Table 2.–Distribution of Selected Sources of Income in 2011

INCOME CATEGORY (1)	Wages	Capital Gains in AGI	Dividend Income	Interest Income	Schedule C Income	Schedule E Income
	$ Billions	$ Billions	$ Billions	$ Billions	$ Billions	$ Billions
Less than $10,000	46.7	0.3	1.2	2.3	15.4	-2.6
$10,000 to $20,000	128.0	0.3	1.9	2.1	30.6	-1.7
$20,000 to $30,000	215.5	0.5	2.4	3.7	18.6	-0.7
$30,000 to $40,000	279.7	0.7	4.6	7.2	15.5	0.7
$40,000 to $50,000	317.3	1.5	6.4	9.4	13.5	1.7
$50,000 to $75,000	878.6	6.7	20.9	26.5	28.8	6.4
$75,000 to $100,000	814.3	9.6	19.1	23.6	24.2	9.0
$100,000 to $200,000	1,984.4	32.0	39.9	37.0	57.8	42.9
$200,000 to $500,000	910.9	42.9	26.6	21.3	48.0	100.7
$500,000 to $1,000,000	231.5	34.2	16.1	10.0	13.6	84.0
$1,000,000 and over	224.4	257.2	60.5	42.8	13.1	312.2
Total, All Taxpayers	6,031.3	385.9	199.5	186.0	279.0	552.6

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

Source: Staff of the Joint Committee on Taxation.

Table 3.–Tax Returns with Income or Employment Taxes in 2011

INCOME CATEGORY (1)	Millions of Returns	Individual Income Taxes	Employment Taxes	Returns with Employment Taxes Greater than Income Taxes	Returns with Employment Taxes Less than Income Taxes	Fraction of Returns with Employment Taxes Greater than Income Taxes
		$ Billions	$ Billions	Millions of Returns	Millions of Returns	
Less than $10,000....................	13.4	-8.7	8.3	13.4	0.0	99.9%
$10,000 to $20,000.............	13.7	-24.1	21.3	13.3	0.4	97.3%
$20,000 to $30,000.............	13.3	-13.5	31.7	12.8	0.6	95.7%
$30,000 to $40,000..............	13.1	0.3	40.2	11.6	1.5	88.8%
$40,000 to $50,000.............	12.4	13.3	45.4	10.0	2.4	80.5%
$50,000 to $75,000.............	24.9	73.6	125.4	18.2	6.7	73.1%
$75,000 to $100,000..............	16.7	91.8	116.8	10.4	6.3	62.3%
$100,000 to $200,000................	22.1	282.8	274.2	12.2	9.9	55.2%
$200,000 to $500,000................	4.9	224.9	96.8	0.3	4.7	5.6%
$500,000 to $1,000,000..................	0.6	95.9	16.0	0.0	0.6	1.9%
$1,000,000 and over..............	0.3	213.3	12.8	0.0	0.3	1.5%
Total, All Taxpayers.........	135.5	949.6	789.0	102.2	33.3	75.4%

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Less than 50,000.

Source: Staff of the Joint Committee on Taxation.

Congress of the United States

JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
http://www.jct.gov

OCT 17 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This is in response to a question raised by Senator Baucus at the September 22nd hearing of the Joint Select Committee on Deficit Reduction, regarding which industries benefit from which major corporate tax expenditures in present law.

Some of the major corporate tax expenditures include the deferral of active income of controlled foreign corporations ("CFCs"), the exclusion of interest on public purpose State and local government obligations, the deduction for income attributable to domestic production activities, accelerated depreciation, the credit for research activities, and the tax credit for low-income housing. The attached table provides information on the distribution of amounts related to these items as claimed on tax returns of active corporations, including C corporations and other active corporations for 2008 by industrial sector. It does not report a distribution of the tax expenditure benefits. In addition it provides information on the distribution of total corporate tax returns filed, total assets, total receipts, net income (less deficit), and total income tax after credits for reference.

While the greatest percentage of corporations are concentrated in the professional, scientific, and technical services and construction sectors, each of these accounts for only about one percent of total assets. The finance and insurance sector has the largest share of total assets at 44.1 percent, though the assets in this sector are not generally depreciable or depletable assets subject to accelerated cost recovery. The manufacturing sector accounts for the largest share of receipts, net income, and total income tax after credits.

Direct data are not available on the deferral of active income of CFCs. However, one may infer information about the distribution by sector of deferred income of CFCs from the

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

distribution of other data reported on tax returns. The attached table reports a measure of current year deferred income for CFCs with positive earnings and profits before income taxes.[1] The most recent year for which data are available is 2006.[2] The manufacturing sector accounts for 30.1 percent of this measure of deferred income of CFCs. Holding companies (18.7 percent), the finance and insurance sector (16.7 percent), and wholesale trade sector (10.1 percent) also have significant deferred income.

The vast majority (80 percent) of tax-exempt interest on State and local government obligations reported by corporations is reported by corporations in the finance and insurance sector. Holding companies report 13.9 percent of such interest, while the manufacturing sector accounts for 2.1 percent. All other industries report less than one percent of the total.

Manufacturing accounts for largest share of the domestic production activities deduction (66 percent). The information (12.1 percent) and mining (seven percent) sectors are the only other sectors in which the domestic production activities deduction exceeds five percent.

Depreciation deductions are also heavily concentrated in the manufacturing sector (27.7 percent). These deductions do not represent the extent to which tax depreciation is in excess of the alternative depreciation system or some other measure of economic depreciation. However, to the extent that accelerated depreciation is likely to benefit those sectors with a larger share of depreciation deductions in general, the manufacturing sector likely receives a large share of the benefit from accelerated depreciation. Other sectors with a large share of depreciation deductions include information (10.9 percent), retail trade (7.5 percent), wholesale trade (seven percent), and utilities (seven percent).

---

[1] The table reports the distribution of current earnings and profits after income taxes for foreign corporations with positive before-tax current earnings and profits. To adjust this amount for income subject to current U.S. income tax, it is necessary to subtract dividends paid to controlling U.S. corporations and total subpart F income. This measure does not measure the deferred active income of CFCs to the extent that current year dividends are paid out of prior year earnings and profits, prior year earnings and profits were deferred, and other provisions which may influence multiple tax years.

[2] Lee Mahony and Randy Miller, "Controlled Foreign Corporations, 2006," *Statistics of Income Bulletin*, 30(3), Winter 2011, pp. 197-259.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

Depletion is heavily concentrated in the mining (65.9 percent) and manufacturing (23.7 percent) sectors. As with depreciation, the deductions shown here do not represent the extent to which tax rules provide more generous treatment than the underlying economic decline in value of the assets over time would warrant. However, to the extent that the benefits of accelerated depletion are correlated with depletion deductions in general, the mining and manufacturing sectors likely receive a large share of these benefits.

The tax credit for research activities and the tax credit for low-income housing are the two largest components of the general business credit, which also includes dozens of smaller credits. These two credits have very little overlap in their beneficiaries. More than 90 percent of the total dollar amount of the research credit is claimed by corporations in the manufacturing (69.3 percent); information (11.4 percent); or professional, scientific, and technical services (9.5 percent) sectors. These sectors collectively only claim about five percent of the low-income housing tax credit. Two sectors claim over 90 percent of low-income housing tax credits: holding companies (48.8 percent), and finance and insurance (41.8 percent).

The general business credit is composed of dozens of smaller credits. The final column of the attached table reports the distribution of selected remaining components of the general business credit for which data are available. Holding companies claim 19.7 percent of the other general business credits, primarily attributable to the new markets tax credit, followed by manufacturing (19.2 percent). The accommodation and food services sector accounts for the next largest share of the other general business credits (16.3 percent), primarily attributable to the credit for employer Social Security and Medicare taxes on tips and the work opportunity tax credit. The retail trade sector claims nearly 10 percent of other general business credits, including claiming the largest share of the work opportunity tax credit.

The utilities sector is responsible for 8.9 percent of other general business credits. Chief among these are the investment tax credit (including the energy credit) and the renewable electricity production credit.

Present law also includes additional energy-related tax expenditures, many of which primarily benefit the mining, utilities, and manufacturing sectors. These include incentives for renewable and alternative fuels, energy conservation credits, alternative fuel vehicle credits,

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

special cost recovery provisions, various fossil fuel energy credits, tax-exempt bond provisions, and other energy provisions.[3]

I hope this information is helpful. If you have further questions related to these materials, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Attachment

[3] For a summary of present-law energy -related Federal tax incentives, see Joint Committee on Taxation, *Present Law and Analysis of Energy-Related Tax Expenditures and Description of the Revenue Provisions Contained in H.R. 1380, the New Alternative Transportation to Give Americans Solutions Act of 2011* (JCX-47-11), September 20, 2011.

Percentage Distribution of Corporate Income Tax Returns and Selected Tax Items by Sector, 2008

Sector	Total Returns	Total assets	Total receipts	Net income (less deficit)	Total income tax after credits	CFC current earnings and profits less adjustments[2]	Interest on Government obligations: State and local	Domestic production activities deduction	Depreciation deduction	Depletion deduction	Current year research activities credit	Current year low-income housing credit	General busines credit (excl. R&E, LIHTC)
Agriculture, Forestry, Fishing, and Hunting	2.3%	0.2%	0.6%	0.1%	0.3%	0.2%	0.1%	0.6%	1.2%	0.3%	0.1%	(1)	0.3%
Mining	0.7%	1.2%	1.6%	5.0%	4.3%	7.7%	0.1%	7.0%	4.4%	65.9%	0.4%	(1)	0.3%
Utilities	0.1%	2.1%	2.7%	0.7%	2.6%	1.4%	0.2%	3.3%	7.0%	2.0%	0.6%	0.8%	8.9%
Construction	13.1%	1.0%	5.2%	2.7%	1.6%	0.4%	0.3%	2.6%	3.2%	0.7%	0.1%	1.7%	1.4%
Manufacturing	4.6%	13.5%	28.6%	40.3%	32.2%	30.1%	2.1%	66.0%	27.7%	23.7%	69.3%	2.8%	19.2%
Wholesale Trade	6.5%	2.6%	13.8%	8.0%	8.5%	10.1%	0.5%	4.4%	7.0%	4.6%	4.2%	0.5%	3.0%
Retail Trade	10.3%	2.1%	12.4%	5.9%	8.8%	1.7%	0.5%	1.0%	7.5%	0.1%	1.0%	0.3%	9.8%
Wholesale and Retail Trade not Allocable	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Transportation and Warehousing	3.3%	0.9%	2.9%	1.3%	2.4%	0.8%	0.2%	0.0%	5.7%	0.1%	0.1%	0.7%	2.9%
Information	2.0%	3.2%	3.9%	5.7%	7.4%	2.8%	0.7%	12.1%	10.9%	(1)	11.4%	2.4%	0.2%
Finance and Insurance	4.3%	44.1%	12.9%	16.1%	16.0%	16.7%	80.0%	0.3%	5.3%	0.9%	1.7%	41.8%	7.2%
Real Estate and Rental and Leasing	11.1%	1.9%	1.2%	1.9%	1.0%	1.2%	0.5%	0.1%	6.4%	0.3%	0.1%	0.1%	0.6%
Professional, Scientific, and Technical Services	14.5%	1.0%	3.7%	3.6%	2.8%	6.9%	0.4%	1.5%	2.2%	0.3%	9.5%	(1)	4.2%
Holding Companies	0.8%	24.4%	3.6%	1.9%	7.8%	18.7%	13.9%	0.4%	4.6%	0.4%	0.7%	48.8%	19.7%
Administrative and Support and Waste Management and Remediation Services	4.7%	0.4%	1.7%	1.6%	1.2%	0.7%	0.1%	0.1%	1.4%	0.6%	0.3%	(1)	3.2%
Educational Services	0.9%	0.1%	0.2%	0.3%	0.3%	0.1%	0.1%	(1)	0.2%	(1)	(1)	(1)	(1)
Health Care and Social Assistance	7.1%	0.4%	2.3%	3.1%	1.2%	0.1%	0.2%	(1)	1.7%	(1)	0.4%	(1)	1.9%
Arts, Entertainment, and Recreation	2.1%	0.1%	0.4%	0.2%	0.2%	0.1%	(1)	(1)	0.7%	(1)	(1)	(1)	0.3%
Accommodation and Food Services	5.0%	0.6%	1.6%	1.1%	1.0%	0.4%	(1)	0.3%	2.3%	(1)	(1)	(1)	16.3%
Other Services	6.3%	0.2%	0.7%	0.4%	0.3%	0.2%	0.1%	0.1%	0.7%	(1)	(1)	(1)	0.5%
Not Allocable	(1)	(1)	(1)	(1)	(1)	0.0%	(1)	(1)	(1)	(1)	(1)	(1)	(1)
All	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

(1) Less than 0.1 percent.
(2) Data from 2006.
Source: Joint Committee on Taxation staff calculations based on Internal Revenue Service, Statistics of Income data.

THOMAS A. BARTHOLD
CHIEF OF STAFF

BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF

Congress of the United States
JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6453
(202) 225–3621
http://www.jct.gov

SEP 23 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This letter is in response to a question from Senator Portman during Thursday's hearing of the Joint Select Committee on Deficit Reduction concerning the revenue effect of repealing or "patching" the alternative minimum tax ("AMT").

Present law imposes an alternative minimum tax on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual's tentative minimum tax is the sum of: (1) 26 percent of the first $175,000 of the excess of alternative minimum taxable income ("AMTI") over the AMT exemption amount; and (2) 28 percent of the remaining excess. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual's taxable income adjusted to take account of the specified preferences and adjustments.

The exemption amount is $48,450 ($74,450 in the case of married individuals filing a joint return) for tax year 2011. For taxable years beginning after 2011, the exemption amount is $33,750 ($45,000 in the case of married individuals filing a joint return).

For taxable years beginning before 2012, nonrefundable personal credits are allowed to the extent of the full amount of the individual's regular and alternative minimum tax. From 2006 to 2011, the AMT exemption amount has been increased annually to hold the number of taxpayers affected by the AMT at a specified level. The target for the number of taxpayers affected by the AMT has changed over time.

One proposal (included in the President's Fiscal Year 2012 Budget Proposal) is to change the AMT exemption amounts to hold the number of taxpayers affected by the AMT at a given level would be to index the AMT exemption amounts for inflation. Under this alternative, the

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
United States Congress

individual AMT exemption amounts, the thresholds for the phase out of the exemption amounts, and the income threshold for the beginning of the 28-percent bracket would be indexed for inflation. In addition, nonrefundable personal credits would be allowed to apply against the AMT. A second proposal suggested by Senator Portman would repeal the individual AMT.

For both proposals, we are providing estimates of the proposals under the present law baseline and under an alternative baseline that assume the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and the Job and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA") are permanently extended.

For purposes of estimating the proposals, we have assumed the proposals would be effective for taxable years beginning after December 31, 2011. We estimate that the proposals would have the following effect on Federal fiscal year budget receipts:

	Fiscal Years [Billions of Dollars]											
Item	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2012-16**	**2012-21**
Index the individual AMT income bracket, exemption phase out, and exemption amount, and allow personal credits against the AMT:												
Present-law baseline	-9.0	-92.5	-39.5	-45.4	-53.3	-62.5	-73.9	-88.0	-103.5	-121.0	-239.7	-688.6
EGTRRA/JGTRRA extended............	-9.0	-129.9	-105.8	-118.7	-134.1	-151.1	-171.7	-195.6	-220.7	-247.9	-497.6	-1,484.6
Repeal the AMT:												
Present-law baseline	-12.4	-125.9	-49.4	-55.9	-64.4	-74.1	-86.2	-100.7	-116.5	-134.4	-308.1	-820.1
EGTRRA/JGTRRA extended............	-12.4	-177.2	-140.1	-155.6	-173.7	-193.4	-216.9	-243.0	-270.3	-299.8	-659.0	-1,882.4

NOTE: Details may not add to totals due to rounding.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
United States Congress

Page 3

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Congress of the United States
JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
http://www.jct.gov

OCT 04 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This is in response to a question raised by Senator Portman at the September 22nd hearing of the Joint Select Committee on Deficit Reduction regarding the effect on economic growth of modifying or curtailing accelerated depreciation.

Economic growth depends in part on the growth of investment. The cost of capital for new investment is influenced not only by accelerated depreciation and other capital cost recovery rules, but also by income tax rates for individuals and corporations, the tax treatment of dividends and capital gains, and whether a taxpayer is in a net loss position. To estimate the cost of capital, it is also necessary to make judgments about future interest and inflation rates, as these affect the real (inflation-adjusted) cost of funds used to finance the investment. The user cost of capital also incorporates the rate of economic depreciation, that is, the rate at which the productivity of different types of plant and equipment decline with respect to age. Firms must earn enough from capital investments to recover this economic depreciation; otherwise they would be better off investing in some other asset.

Curtailing accelerated depreciation would increase the cost of new capital investment, which could reduce the overall incentive to save and invest and have a negative effect on economic growth. Without other changes to the tax system, this change could also affect the choice of investment. For example, curtailing accelerated depreciation raises the effective tax rate on business investment without changing the tax treatment of investments in owner-occupied housing. This increases the tax advantage of owner-occupied housing relative to other investments. Furthermore, because those assets that receive accelerated depreciation under present law are more heavily concentrated in the corporate sector, curtailing accelerated depreciation generally increases the difference in taxation between corporate and noncorporate investment. However, to the extent that different types of assets face different degrees of accelerated depreciation under present law, curtailing accelerated depreciation could improve the

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

allocation of investment capital within the corporate and noncorporate sectors. If the net effect of these changes improves the neutrality of the tax system with respect to investment choice, this could have a positive effect on economic growth.[1]

A reduction in the corporate tax reduces the cost of new capital investment, which may encourage additional investment and economic growth. However, this reduction applies to the returns both to new investment and old investment alike and thus in part provides a benefit to investment decisions made in the past without offering an additional incentive for new investment. A rate reduction could also affect economic growth through its effect on the composition of investment. It reduces the burden on investment in the corporate sector relative to the noncorporate sector, helping to equalize the treatment between the two. A rate reduction also reduces the distortional effect of other provisions of the corporate income tax, which could have a positive effect on economic growth.

In general, modifying or curtailing accelerated depreciation and using the proceeds to reduce the statutory corporate income tax rate would have offsetting effects on economic growth. Without information about the specifics of a particular proposal, it is not possible to determine which effects on economic growth would dominate.

---

[1] A study by the U.S. Department of the Treasury suggests that the overall effect on the neutrality of the tax system by such a change may be negligible. U.S. Department of the Treasury, *Report to the Congress on Depreciation Recovery Methods*, July 2000, p.48.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

I hope this information is helpful. If you have further questions related to these materials, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Congress of the United States
JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6453
(202) 225–3621
http://www.jct.gov

THOMAS A. BARTHOLD
CHIEF OF STAFF

BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF

OCT 07 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This letter is a response to a question asked by Senator Portman at the September 22 hearing of the Joint Select Committee on Deficit Reduction. Senator Portman inquired about how a corporate tax rate reduction, achieved by repealing business tax expenditures, could be designed so as not to disadvantage passthrough entities.

Present Law

As discussed in greater detail in my testimony, businesses may be organized under a number of different legal forms. An owner of a business may conduct business as a sole proprietorship which does not involve a legal entity separate from the owner. However, for a variety of business and other reasons, a business is often conducted through a separate legal entity.[1]

Under present law, the tax consequences of conducting business through a separate entity depend on the type of entity chosen. Partnerships, limited liability companies that are taxed as partnerships, and S corporations generally are not subject to tax at the entity level, but rather, their partners, members or shareholders, respectively, take into account partnership or S

---

[1] Note that an individual conducting business through a wholly-owned limited liability company is treated for nontax purposes as doing business as a legal entity; however, for Federal income tax purposes, if the limited liability company qualifies as a disregarded entity, the individual is not treated as doing business through a separate legal entity.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

corporation items of income, gain, loss, deduction and credit. For this reason, partnerships and S corporations are commonly referred to as "passthrough" or "flowthrough" entities. Income of these passthrough entities is taxable to the partners or shareholders whether or not such income is actually distributed.

In contrast, the income of a C corporation is taxed at the corporate level. Shareholders are taxed on corporate after-tax earnings only when paid as dividends, or upon disposition of their shares of stock of the corporation (to the extent gain on sale (if any) is attributable to undistributed corporate income). Thus, the income of a C corporation may be subject to tax at both the corporate and the shareholder levels, but is subject to tax at the shareholder level only when distributed (or realized upon a stock disposition).

Under present law, there are no restrictions on the persons that may be partners in a partnership (or members of an LLC) or shareholders in a C corporation. However, permitted shareholders of an S corporation are limited to individuals (excluding nonresident alien individuals), estates, certain trusts owned entirely by citizens or residents of the United States, and certain types of tax-exempt organizations. Accordingly, both individuals and nonbusiness entities that are shareholders in an S corporation, or partners in a partnership, can benefit from tax expenditures that apply to business activities conducted by such S corporation or partnership. Therefore, as noted by Senator Portman in the context of his inquiry, if a corporate tax rate reduction is funded, in whole or in part, by limiting or eliminating business tax expenditures, it is possible that individuals conducting business as sole proprietorships or in passthrough form could lose the benefit of those expenditures without an offsetting tax rate reduction.

Analysis

There are a variety of ways one might attempt to mitigate the impact of limiting or eliminating business tax expenditures on persons conducting business as sole proprietors or in passthrough form. However, each of the alternatives has significant drawbacks and could require a significant investment of time to develop and administer. Also, noteworthy is that business tax expenditures take different forms. The choice of expenditures eliminated may itself mitigate the impact on individuals, or it may be the case that one alternative would be more appropriate than another depending upon the specific expenditure subject to limitation. For example, the deduction for income attributable to domestic production activities is a deduction calculated at the partner or shareholder level in the case of partnerships and S corporations.

Accordingly, eliminating this expenditure for corporations would not impact the ability of individuals to claim the deduction directly, or through a passthrough entity. On the other hand, as discussed in greater detail below, the elimination of other expenditures (like accelerated depreciation) is more complicated. Following is a brief discussion of some alternatives and issues each presents.

Limit or eliminate expenditures for C corporations only

One alternative is to limit or eliminate business tax expenditures for C corporations only. In other words, different Federal income tax rules governing a deduction, credit or other provision would apply for C corporations on one hand and other businesses on the other.

Although intuitively appealing, this option presents significant administrative difficulties in particular circumstances. Consider, for example, the depreciation of equipment in excess of the alternative depreciation system. If the depreciation rules for a piece of equipment differ depending upon whether the equipment is held by a partnership or by a C corporation, tiered structures and joint ventures involving both corporations and partnerships could make determination of allowable depreciation complex. Among other issues, those depreciation rules would have to address the depreciation of an asset owned by a partnership with corporate and noncorporate partners, and the related complexity presented by tiers of partnerships.

For example, a simple approach that provides one rule for corporations and another rule for noncorporate entities may have little effect, because a corporation subject to a less favorable depreciation rule might restructure its asset holdings to exploit the rule difference. Alternatively, in the simple case of a partnership with two partners, one a corporation and the other an individual, there are at least three conceptual approaches to the issues presented: (1) maintain two depreciation schedules for each partnership asset; (2) compute partnership income twice, once for corporate partners and once for noncorporate partners; and (3) treat any partnership with a corporate partner as a corporation for purposes of the expenditure. The practicality of these (or other) alternatives would require further assessment.

Maintain separate schedules

In a partnership with corporate and noncorporate partners, one could attempt to split each partnership asset into a corporate piece and a noncorporate piece according to the ownership

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

interests of each and depreciate the asset accordingly. Practically, this option would be exceedingly difficult to implement. Given the inherent flexibility of partnerships, a partner's interest in particular partnership assets may be difficult to ascertain. In addition, while assets are depreciated on an annual basis, the composition of a partnership's partners may change at any time, including during the course of a single taxable year. Perhaps more importantly, a partnership may not always know the tax status of its ultimate partners, particularly if partnerships are tiered. For example, a partnership interest may be held by another partnership with many partners, some of which may be partnerships themselves. This tiering of partnerships could make it practically impossible for a partnership to know how to split an asset for depreciation purposes.

Calculate taxable income twice

As an alternative to splitting partnership assets, a partnership with corporate and noncorporate partners could be required to calculate its taxable income twice, first depreciating its assets according to the corporate rules and a second time according to the noncorporate rules. The partnership could then send two K-1s to partners, one for corporations and the other for other taxpayers. Apart from doubling the accounting work required for partnerships, this option presents difficulties similar to those discussed above. In a partnership with another partnership as partner, it is unclear whether the partnership should use the individual K-1, the corporate K-1, or a pro rata portion of each in computing its own taxable income. In addition, although the partnership could report income separately, it is unclear how one would calculate the partnership's basis in the asset for purposes of calculating, for example, partnership gain or loss if the asset were sold.

Treat certain partnerships as corporations for expenditure purposes

One could attempt to solve the tiered partnership issue with a rule that any partnership with a corporate partner would be treated as a corporation for purposes of the relevant expenditure (in this example, depreciation). Without a reporting requirement, tiered partnerships would not know whether to treat other partnerships as corporations for this purpose. For example, under this approach, a lower-tier partnership could be required to change the depreciation of its assets because an individual partner in an upper-tier partnership transferred his interest to a corporation, and yet such lower-tier partnership would not (under present law) have any reason to know of the transfer. Moreover, a rule requiring partnerships with direct or

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

indirect corporate partners to apply corporate rules for certain purposes would also change the tax results for individuals in such partnerships.

Establish a preferential rate for passthrough business income

A second alternative is to repeal (or partially repeal) tax expenditures for all types of business, but to compensate individual owners by providing a preferential tax rate for the business income of individuals in the case of businesses conducted as sole proprietorships or through passthrough entities. For purposes of illustration, assume that deferral of gain on like-kind exchanges were repealed, and that this raises $16 billion from corporations and $2 billion from individuals. Then corporate rates could be reduced to lose $16 billion and the income tax rate on the business income of individuals could be reduced to lose $2 billion. There are a variety of ways to accomplish a rate reduction for just the business income of individuals. For example, Congress could establish a separate rate for such income, just as there are preferential rates for long-term capital gain. Alternatively, Congress could provide a deduction for income attributable to business activities similar to the deduction for domestic production activities.

A number of practical issues would have to be resolved to implement such approaches. An initial question is how to define "business income" for which a lower rate would be allowed. A related question is whether to benefit all persons with such income, or to restrict the lower rate to a subset of qualifying persons with qualified income. Another question is how the lower rate would be determined. The above example uses a uniform reduction determined by the amount of money raised. However, it is unlikely that the impact of limiting expenditures would be uniform across all passthrough entities and individuals, and not all individuals pay individual income taxes at the same rate.

Broader concepts

It should be noted that, although not directly responsive to your inquiry, other broader approaches to reducing the taxation of corporate earnings have been proposed over the years. For example, there have been a number of different proposals to effectively eliminate the

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

corporate income tax by integrating the corporate and individual income taxes.[2] Corporate integration proposals are complex, and present a variety of policy issues including, for example, the proper treatment of tax-exempt entities and foreign persons in an integrated system. Any corporate integration proposal would require transition rules and would take time to develop and implement.

I hope that this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

cc: Honorable Max Baucus, Honorable Xavier Becerra, Honorable Dave Camp, Honorable James E. Clyburn, Honorable John F. Kerry, Honorable Jon Kyl, Honorable Rob Portman, Honorable Pat Toomey, Honorable Fred Upton Honorable Chris Van Hollen, and Mark Prater

---

[2] For a more extensive discussion of the background and issues related to integration, see Michael J. Graetz and Alvin C. Warren, Jr., *Integration of the U.S. Corporate and Individual Income Taxes* (Tax Analysts, 1998); Joint Committee on Taxation, *Present Law and Background Relating to Selected Business Tax Issues* (JCX-41-06), September 19, 2006, pp. 26-30; Joint Committee on Taxation, *Federal Income Tax Aspects of Corporate Financial Structures* (JCS-1-89), January 18, 1989, pp. 82-103. Four integration prototypes are detailed in the 1992 Treasury report, *A Recommendation for Integration of the Individual and Corporate Tax Systems, Taxing Business Income Once* (1992).

Congress of the United States

JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
http://www.jct.gov

OCT 03 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This letter is a response to a question asked by Senator Kerry at the September 22 hearing of the Joint Select Committee on Deficit Reduction. Senator Kerry asked whether the staff of the Joint Committee on Taxation could provide information about the territorial tax systems of other countries and about options for reform of the U.S. rules for taxing cross-border business income.

The staff of the Joint Committee recently has researched territorial taxation. In connection with a May 24, 2011, House Ways and Means Committee hearing, we prepared a pamphlet that describes the current U.S. international tax system and issues related to that system and that provides information about the territorial tax systems of nine Asian, European, and North American countries. As described in detail in that pamphlet, territorial tax regimes share common characteristics. Territorial systems generally exempt foreign business income from home-country tax by means of a dividend exemption. These systems typically impose tax on passive or highly mobile income. Many systems impose home-country tax on income subject to low foreign tax rates. Territorial systems do not typically disallow deductions for expenses related to exempt foreign income, but as an alternative to disallowing deductions some systems tax a portion (for instance, five percent) of otherwise exempt dividends.

Within these broad similarities found among countries that have adopted territorial systems, there is great variety in the rules of various jurisdictions. For example, different countries have different rules for the treatment of foreign branches. Some countries restrict deductions for domestic interest expense. And some countries have special rules for the taxation of income related to intangible property.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

In case your Committee would like to have more information about the current U.S. international tax rules and about territorial taxation generally and in nine select countries, I have enclosed our recent pamphlet.

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

Enclosure: JCX-33-11 *

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

* See "Background and Selected Issues Related to the U. S. International Tax System and Systems that Exempt Foreign Business Income," Joint Committee on Taxation staff report, May 24, 2011 (JCX-33-11), *http://www.jct.gov/publications.html?func=startdown&id=3793*.

Congress of the United States

JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6453
(202) 225–3621
http://www.jct.gov

THOMAS A. BARTHOLD
CHIEF OF STAFF

BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF

OCT 17 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon House Office Building
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This letter is in response to a question raised by Representative Van Hollen at the September 22, 2011, hearing of the Joint Select Committee on Deficit Reduction regarding information about the capital asset types that are taxed either as long or short term capital gains.

Under present law, generally, equity investments held for more than a year receive preferential treatment with a lower tax rate of 15 percent (0 percent for taxpayers otherwise in the 15 percent ordinary income bracket) in 2011. After December 31, 2012, the preferential rate increases to 20 percent (and 10 percent). Capital losses may be claimed to the extent of capital gains plus $3,000 ($1,500 in the case of a married filing separate return). Losses in excess of the $3,000 threshold may be carried forward to future years.

From time to time, the Statistics of Income division of the Internal Revenue Service edits and compiles data on the sales of capital assets. The most recent comprehensive data set is from tax year 2007. The following table shows the distribution of capital gains by asset type. The table below shows the dollar value of gains and the percentage distribution by asset type. Columns 1 shows the net gain or loss from short and long term capital gains reported on 2007 tax year individual income tax returns. Column 2 reports the percentage distribution. Twenty five percent is identified as corporate stock. However, mutual fund distributions that show up in two different lines on the table below (Mutual funds, except tax-exempt bond funds, and Capital gain distributions) could also contain corporate stock. Mutual funds represent 12.5 percent of the total amount of gains in line 1 column 1. Assuming that mutual funds assets are distributed similarly to the rest of capital gains (excluding pass-through income and mutual funds) would add an additional 7.4 percent to the total amount of corporate stock, for a total of 32.3 percent of short and long term capital gains and losses.[1] Column 3 reports the capital gains excluding any losses for short and long term gains and column 4 reports the percentage of the "total" reported in

[1] Total capital gains in column1 excluding pass through gains and mutual funds is $383.829 billion. Corporate stock as a share of the $383.829 is 59.4 percent. Multiplying the $114.2 billion in mutual funds by 59.4 percent results in an additional $67.8 billion, or 7.4 percent, attributable to corporate stock.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

column 3 ($1.1 trillion). 28.9 percent is reported as corporate stock. Grossing this number up in a similar manner as above for the mutual funds results in 36 percent of capital gains attributable to corporate stock. Similar calculations for columns 5 and 7 result in 33.4 percent of long-term gains and losses, and 36 percent of long-term gains are attributable to corporate stock.

I hope this information is helpful. If you have further questions related to these materials, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

Enclosure

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Tax Year 2007 Individual Sales of Capital Assets

Asset Type	Short and Long Term Capital Gains				Long Term Capital Gains			
	All Transactions		Gain Transactions		All Transactions		Gain Transactions	
	Net Gain/Loss (1)	Percent of Total (2)	Gain (3)	Percent of Total (4)	Net Gain/Loss (5)	Percent of Total (6)	Gain (7)	Percent of Total (8)
Total	**914,042,040**		**1,106,865,343**		**872,954,607**		**970,360,118**	
Corporate stock	227,899,475	24.9%	320,121,692	28.9%	223,289,657	25.6%	271,314,848	28.0%
U.S. Government obligations	211,005	0.0%	695,864	0.1%	48,897	0.0%	301,382	0.0%
State and local government obligations	784,132	0.1%	2,230,513	0.2%	900,335	0.1%	2,027,500	0.2%
Other bonds, notes, and debentures	-238,117	0.0%	1,825,251	0.2%	120,725	0.0%	1,503,882	0.2%
Put and call options	2,674,767	0.3%	11,175,605	1.0%	1,050,906	0.1%	1,583,689	0.2%
Futures contracts	8,381,409	0.9%	19,276,305	1.7%	221,912	0.0%	452,510	0.0%
Mutual funds, except tax-exempt bond funds	28,129,389	3.1%	43,612,621	3.9%	28,333,592	3.2%	36,788,137	3.8%
Tax-exempt bond mutual funds	-691,750	-0.1%	755,948	0.1%	-346,380	0.0%	678,035	0.1%
Partnership, S corporation, and estate or trust interests	49,145,134	5.4%	58,928,225	5.3%	48,952,209	5.6%	56,299,450	5.8%
Livestock	2,411,515	0.3%	2,748,594	0.2%	2,230,920	0.3%	2,435,480	0.3%
Timber	1,366,931	0.1%	1,425,844	0.1%	1,360,156	0.2%	1,403,844	0.1%
Involuntary conversions	256,902	0.0%	562,436	0.1%	487,267	0.1%	533,212	0.1%
Residential rental property	37,311,783	4.1%	42,569,377	3.8%	36,248,279	4.2%	40,437,234	4.2%
Depreciable business personal property	2,297,692	0.3%	3,536,167	0.3%	2,207,324	0.3%	3,070,205	0.3%
Depreciable business real property	26,357,298	2.9%	27,843,783	2.5%	25,788,332	3.0%	27,077,263	2.8%
Farmland	4,584,038	0.5%	4,649,821	0.4%	4,560,809	0.5%	4,608,429	0.5%
Other land	25,682,168	2.8%	26,813,625	2.4%	25,024,681	2.9%	26,001,027	2.7%
Residences	12,832,996	1.4%	14,861,287	1.3%	12,549,713	1.4%	14,503,330	1.5%
Other assets	25,724,929	2.8%	44,093,416	4.0%	29,148,237	3.3%	37,117,308	3.8%
Unidentifiable	5,981,865	0.7%	8,340,659	0.8%	5,902,814	0.7%	7,173,447	0.7%
Passthrough gains or losses	366,909,407	40.1%	384,769,237	34.8%	338,845,149	38.8%	349,020,830	36.0%
Capital gain distributions	86,029,074	9.4%	86,029,074	7.8%	86,029,074	9.9%	86,029,074	8.9%

NOTE: Source: Statistics of Income Sales of Capital Assets by Asset Type, 2007.

112TH CONGRESS, 1ST SESSION

HOUSE	SENATE
DAVE CAMP, MICHIGAN, CHAIRMAN	MAX BAUCUS, MONTANA, VICE CHAIRMAN
WALLY HERGER, CALIFORNIA	JOHN D. ROCKEFELLER IV, WEST VIRGINIA
SAM JOHNSON, TEXAS	KENT CONRAD, NORTH DAKOTA
SANDER M. LEVIN, MICHIGAN	ORRIN G. HATCH, UTAH
CHARLES B. RANGEL, NEW YORK	CHUCK GRASSLEY, IOWA

THOMAS A. BARTHOLD
CHIEF OF STAFF

BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF

Congress of the United States
JOINT COMMITTEE ON TAXATION
1625 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6453
(202) 225–3621
http://www.jct.gov

OCT 04 2011

Honorable Patty Murray
United States Senate
Joint Select Committee on Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

Honorable Jeb Hensarling
U.S. House of Representatives
Joint Select Committee on Deficit Reduction
129 Cannon HOB
Washington, D.C. 20515

Dear Senator Murray and Mr. Hensarling:

This is in response to questions raised by Representative Van Hollen at the September 22, 2011, hearing of the Joint Select Committee on Deficit Reduction regarding the amount of revenue that would need to be raised in order to maintain deficit neutrality if corporate income tax rates were decreased.

The relationship between the top corporate income tax rate and corporate tax revenues is not uniform, and the revenues needed to offset an additional one percentage point drop in the top corporate income tax rate grows as the top corporate income tax rate is reduced. To offer a range of estimates of the revenue loss from each percentage point decline, the ten-year cost of a one percentage point reduction in the top corporate income tax rate from 35 percent to 34 percent is approximately $95 billion while the 10-year cost of a one-percentage point reduction from 26 percent to 25 percent is approximately $113 billion.

Please also be aware that reductions in the top corporate income tax rate will interact with many revenue raising provisions such as eliminating corporate income deductions. As a result, if the revenue loss from reducing the top corporate income tax rate is offset by eliminating some deductions to corporate income, eliminating these provisions will raise less revenue than would be the case if no changes were made to the top income tax rate. Thus, depending on the form of the revenue raising provisions, additional revenues will be necessary to account for this interaction. Oppositely, if the corporate base were broadened before the Congress decided to reduce corporate tax rates, each point of rate reduction would cost more than reported above.

Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

Honorable Patty Murray
Honorable Jeb Hensarling
Joint Select Committee on Deficit Reduction

I hope this information is helpful to you. If we can be of further assistance in this matter, please let me know.

Sincerely,

Thomas A. Barthold

Thomas A. Barthold

cc: Honorable Max Baucus
Honorable Xavier Becerra
Honorable Dave Camp
Honorable James E. Clyburn
Honorable John F. Kerry
Honorable Jon Kyl
Honorable Rob Portman
Honorable Pat Toomey
Honorable Fred Upton
Honorable Chris Van Hollen
Mark Prater

Representative Jeb Hensarling

Opening Statement

In last week's testimony regarding the drivers of our structural debt we heard Congressional Budget Office Director Doug Elmendorf say that although government revenues are certainly temporarily down, he expects them to again reach their historic norm of a little over 18 percent of GDP in short order. However, he reminded us that spending is due to explode to over 34 percent of GDP in the years to come. That is principally-driven by entitlement spending programs, some of which are growing two, three, and four times the expected rate of growth of our economy.

As I have maintained from the first meeting of the Joint Select Committee, there are many actions that this committee could take that would be helpful in addressing our structural debt crisis. However, we cannot and will not succeed unless our primary focus is about saving and reforming social safety net programs that are not only beginning to fail many of their beneficiaries but simultaneously going broke.

If we fail to do this and choose to solely or primarily address our debt crisis by increasing the nation's tax burden, I fear the consequences.

Former CBO Director Rudy Penner, in testimony before the Simpson-Bowles Commission, stated, "the U.S. total tax burden, which is considerably below the OECD average, would be higher than today's OECD average by mid-century and within a few years after that we would be the highest taxed nation on earth."

Also appearing before the Simpson-Bowles Commission was former CBO Director and current Social Security and Medicare Trustee Robert Reischauer who stated, "The longer we delay, the greater risk of catastrophic economic consequences. ... The magnitude of the required adjustments is so large that ... raising taxes on the rich or corporations, closing tax loopholes, eliminating wasteful or low-priority programs, and prohibiting earmarks simply won't be enough."

Finally, when he served as CBO Director, Dr. Peter Orszag in a letter to Budget Committee Chairman Paul Ryan stated, "The tax rate for the lowest tax bracket would have to be increased from 10 percent to 25 percent; the tax rate on incomes in the current 25 percent bracket would have to be increased to 63 percent; and the tax rate of the highest bracket would have to be raised from 35 percent to 88 percent. The top corporate income tax rate would also increase from 35 percent to 88 percent."

The ability, wisdom and consequences of addressing our debt crisis through tax increases will continue to constitute a rigorous debate by our Committee.

My hope though is that we may be able to achieve rigorous agreement that fundamental tax reform, even if limited to just American businesses, can result in both revenue from economic growth for the federal government and more jobs for the American people.

Seemingly, both the President of the United States and the Speaker of the House agree. Most Americans agree that there is something fundamentally wrong with our tax code when a small business in East Texas pays 35 percent and a large Fortune 500 company pays little or nothing. There is also something fundamentally wrong with our tax code when an American company pays 35 percent and its chief European competitor only pays 25 percent. We should seize the opportunity and correct this for the sake of both bringing in more revenues through economic growth and addressing our jobs crisis at the same time.

Senator Patty Murray

Opening Statement

"Thank you Co-Chairman Hensarling. I want to thank our witness, Thomas Barthold, for taking the time to be here. As well as my colleagues and the members of the public in the audience and watching on television.

"The American people are looking at this Committee with great optimism—but also with real skepticism. They have heard the partisan rhetoric that has dominated our nation's capital recently – and quite frankly they're tired of it.

"When it comes to this Committee and its work: They don't care how it impacts one party's fortunes vs. the other. They don't care how it impacts one special interest vs. another. Their only question is, can it impact their lives?

"They want to know: Can we help put their spouse, or family member, or neighbor back to work? Can we make a real dent in the deficit so their children are able to compete and succeed? And can it be done in time for families that are losing faith with each passing day?

"Answering those questions is going to take honesty from every member of this Committee, honesty with one another, and honesty with the American people about what it's going to take.

"It's going to mean looking at every part of our budget and realizing that there is: Spending that has grown too fast, job investment that still have to be made, entitlements that are expanding too quickly, and a tax code that's become riddled with corporate giveaways and special-interest carve-outs for the richest Americans.

"But more than anything else, it's going to take the shared realization that solving our deficit crisis and putting Americans back to work will mean taking a truly balanced approach.

"Now to this point in Congress, we have begun the process of addressing spending. In fact, the Budget Control Act that established this Committee cut more than $1 trillion from our national deficit And this was on top of caps to appropriations bills we already put in place.

"But as the overwhelming majority of American families, economists, and every serious, bipartisan commission that has examined this issue has agreed—spending cuts alone aren't going to put Americans back to work or put our budget back in balance.

"We have to address both spending and revenue.

"So I am looking forward to hearing from Mr. Barthold about the tax reforms and revenue this Committee can explore.

"I am interested in hearing about the loopholes and tax expenditures my colleagues on both sides of the aisle have agreed are too often wasteful and market-distorting. About our options for broadening the base, lowering the rate, boosting the economy, and bringing in additional revenue. And about keeping our tax code truly progressive.

"Revenue and the tax code is just one side of the ledger—but it is an important one. And it needs to be a part of the balanced and bipartisan plan we owe it to Americans to come together to pass.

"I'm pleased that this Committee has begun the hard work of negotiations over these last weeks. And I am hopeful that we can come together and deliver the results Americans deserve.

"A balanced plan that helps get our economy back on track, gives businesses the stability to hire again, and ensures that middle class families and the most vulnerable are not bearing the burden of balancing our budget alone.

"Thank you."

○